

WORLD BANK MIDDLE EAST AND NORTH AFRICA REGION
MENA ECONOMIC UPDATE OCTOBER 2019



Reaching New Heights: Promoting Fair Competition in the Middle East and North Africa

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Abbreviations

ATM	Automated Teller Machine
BdL	Bank of Lebanon
CPA	Kuwait's Competition Protection Agency
EU	European Union
FDI	Foreign Direct Investment
FTC	The US Federal Trade Commission
GAC	Saudi Arabia's General Authority for Competition
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GPTs	General purpose technologies
IMF	International Monetary Fund
KIA	Kuwait Investment Authority
MAGG	Morocco's Ministry of General Affairs and Governance
MENA	Middle East and North Africa
MoITS	Jordan's Ministry of Industry and Trade and Supply
MTR	Mass Transit Railway
NFA	Net Foreign Asset
NOCs	national oil companies
NWF	national wealth fund
OCED	The Organisation for Economic Co-operation and Development
OPEC	The Organization of the Petroleum Exporting Countries
PPP	public-private partnership
SEZ	special economic zone
SMEs	small-to-medium sized enterprises
SOEs	state-owned enterprises
SWFs	sovereign wealth funds
UAE	United Arab Emirates
UNCTAD	The United Nations Conference on Trade and Development

Preface: **A Shifting Development Paradigm for the Middle East and North Africa¹**

The Middle East and North Africa (MENA) needs bolder and deeper economic reforms. The unrest that began in the Arab Spring in 2011 has been spurred in large part by young people frustrated by the lack of economic opportunity. GDP growth is projected to be 0.6 percent in the region in 2019, a fraction of what is needed to create enough jobs for the fast-growing working-age population. Even in those few countries that have had periods of higher growth, poverty failed to decline, suggesting a need for reforms to instill fair competition and promote inclusive growth.

A transition from an administered to a market economy is essential to sustain the needed growth, but this prospect arouses considerable mistrust in the region, where many blame market liberalization for the rise of a crony capitalism of a few connected firms.

In fact, it is decades of state dominance, not the periodic episodes of liberalization that encouraged state or private monopolies through subsidies, price controls and barriers to entry and exit.

Even when liberalization efforts are not captured by the powerful few, the remedies are unpopular—whether they entail removal of subsidies or streamlining the workforce at state-owned enterprises—which makes it difficult to get the reforms right. And the big state-owned firms suck up so much financing that small- and medium-sized enterprises, which typically are the most important creators of sustainable jobs, are crowded out of credit markets.

Moreover, the unfair competition that results from markets dominated by state-owned enterprises and connected firms deters private investment, reducing the number of jobs and preventing countless talented youngsters from prospering.

Lack of fair competition may be the underlying reason that MENA economies are unresponsive, but reformers also must grapple with other issues, such as whether inward- or outward- oriented economies are the best vehicles for achieving economic development.

And economic development paradigms have shifted focus over the past decades: from minimizing imports to encouraging exports as the path to prosperity.

MENA countries had little success under the import substitution paradigm: economies were stagnant and high unemployment, especially among young people, prevailed. But aiming for export-led growth had no more success. To enable export-oriented firms to escape the stultifying conditions of their domestic economies, several countries in MENA set up special economic zones (SEZs)-where business and trade laws differed from the rest of the country. But the results were disappointing.

¹ This section was authored by Rabah Arezki.

It is time for MENA countries to focus on both demonopolizing their markets and harnessing the collective domestic demand of their economies to achieve export-led growth regionally and internationally.² Most MENA countries have relatively small markets. But together the region has more than 400 million people, about twice as many as Western Europe. Moreover, while Europe's population growth is virtually stagnant, the population in the MENA region is projected to nearly double by 2050. But as sensible as a move to regional markets might be, it will be difficult to achieve. MENA countries have always preferred to go-it-alone—the region is the least-integrated in the world, despite the potential gains from removing barriers to the flow of goods and services within MENA countries.

Moreover, although steps such as reducing tariffs, solving poor logistics and creating cross-border payment systems will undoubtedly help with regional integration, they are insufficient. At the heart of the inability of MENA countries to integrate domestically and regionally are the almost impenetrable barriers to firms entering or leaving crucial markets—or, as economists put it, the lack of market contestability.³ The economies of MENA have favored incumbent firms—whether private sector or state-owned. The lack of contestability leads to cronyism and what amounts to rent-seeking activity—including, but hardly limited to, exclusive import licenses which reward the holders and discourage both domestic and foreign competition. The lack of domestic market contestability reverberates at the regional level.

To unlock domestic and regional integration, the wall of vested interests in MENA countries must be torn down. In practice, the tear-down could translate to creation of regulatory watchdogs to champion competition. Unleashed regional demand accompanied by arm's length regulation that fosters competition and fights anti-competitive practices could prevent the perpetuation of oligarchies—the powerful few who often seize control of liberalization attempts, with the unfortunate result that the idea of reform is sullied among the citizens.

An integral part of the competition and contestability agenda is transparency and data availability. Countries in the MENA region trail other similar middle-income countries on government transparency and the disclosure of data in critical areas that measure the evolution of poverty, the degree of competition in sectors, and assessment of domestic debt levels and contingent liabilities associated with government guarantees.

The flow of funds between public banks and other state-owned enterprises is opaque and leads to cronyism and corruption. Transparent public procurement can help eradicate this problem.

Access to data will allow for a better evaluation of policies and their continuous improvement. In addition to access to data, freedom of investigation, especially for think tanks, is central to instilling a much-needed domestic debate on economic and social policies, which in turn would foster ownership of reforms and social cohesiveness.

Development partners—such as international financial institutions and donor countries—can help MENA countries. In a coordinated fashion they should raise the issues of contestability and of the need for the creation or the strengthening of credible and independent local bodies to promote competition as a necessary step toward building more inclusive societies. To ensure progress, the partners could advocate pro-competitive reforms and provide technical expertise in the institutional design of competent and independent national and regional regulatory bodies.

² See IMF (2018a) for estimates of economic integration for Maghreb and World Bank (2014a) for the Levant. Beyond economic benefits, the promise of regional integration is to bring peace and stability as it has been for the European Union.

³ Market contestability is a key element of competition. However, contestability might not be sufficient to ensure competitive markets in case consumers cannot readily change their suppliers because of switching costs or network effects (see Baumol and others, 1982). In this report, we use the terms interchangeably since we only consider the supply side of the economy. The term contestability emphasizes the dynamism of the competitive process.

A joint call for action by MENA leaders with the support of the development community could go a long way toward creating intraregional trade, and attracting the foreign direct investment required to create the millions of jobs and the peace and stability the MENA region needs.

This report is in two parts. Part I discusses the short- and medium-term growth prospects for countries in the Middle East and North Africa. The region is expected to grow at a subdued rate of 0.6 percent in 2019, rising to 2.6 percent in 2020 and 2.9 percent in 2021. The growth forecast for 2019 is revised down by 0.8 percentage points from the April 2019 projection. MENA's economic outlook is subject to substantial downside risks—most notably, intensified global economic headwinds and rising geopolitical tensions.

Part II of the report argues that promoting fair competition is key for MENA countries to complete the transition from an administered to a market economy. Part II first examines current competition policies in MENA countries and to promote fair competition calls for strengthening competition law and enforcement agencies. It also calls for corporatizing state-owned enterprises, promoting the private sector and creating a level-playing field between them. Any moves to reform MENA economies would be aided by professional management of public assets, which could tap into a new source of national wealth.

Part I. MENA's Growth Prospects

This part reviews the latest World Bank growth forecasts for MENA. It focuses first on the growth prospects for 2019, then presents the forecasts for 2020 and 2021. The chapter also discusses various macroeconomic developments for the economies in the region, grouped by their level of development and by their dependence on oil exports.

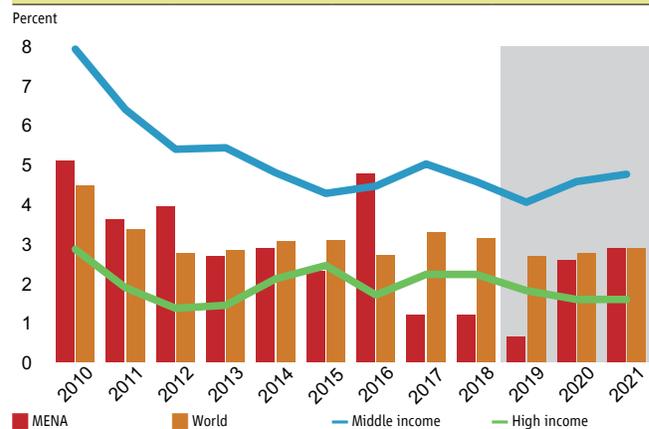
CHAPTER 1. GROWTH PROSPECTS FOR 2019

Growth Prospects for the Middle East and North Africa

World Bank economists expect real GDP growth for the Middle East and North Africa region to average 0.6 percent in 2019 (see Figure I.1 and Table I.1), lower than the 1.2 percent growth in 2018. Sluggish performance is expected in 2019, the result of voluntary oil production cuts and weak external demand. Iran's economy, affected by U.S. sanctions, is contracting further. Compared to the April 2019 MENA Economic Update, the 2019 growth forecast is revised down by 0.8 percentage points, with across-the-board downgrades to many MENA economies from an already low starting point (see Table I.2). Lower oil prices since April 2019 and a larger-than expected contraction in Iran are behind these downgrades.⁴

In per capita terms, the region's average income is expected to decline by 0.9 percent in 2019. This follows a contraction of 0.6 percent in 2018. What is more, poverty rates remain high in the region, even in countries that have experienced relatively high economic growth such as Egypt and Djibouti.⁵ This points to the need for deeper reforms advocating fair competition to promote more inclusive growth.

Figure I.1. Growth in MENA and the World



Source: World Bank.

Note: Middle income countries include the world's upper middle income countries and lower middle income countries. Shaded area indicates forecasts. Data for 2018 are estimates.

⁴ Without including Iran, the region's real GDP growth would be 2.2 percent in 2019.

⁵ In Egypt, 32.5 percent of population lived below national poverty line, according to official report in 2018. In Djibouti, official national extreme poverty rate stood at 21.1 percent as of 2017.

Table I.1. Growth, Current Account and Fiscal Balance Forecasts																				
	Real GDP Growth (percent)					Real GDP per capita Growth (percent)					Current Account Balance (percent of GDP)				Fiscal Balance (percent of GDP)					
	2017	2018e	2019f	2020f	2021f	2017	2018e	2019f	2020f	2021f	2017	2018e	2019f	2020f	2021f	2017	2018e	2019f	2020f	2021f
MENA	1.2	1.2	0.6	2.6	2.9	-0.7	-0.6	-0.9	0.9	1.3	0.1	3.8	1.1	1.0	1.0	-6.4	-3.7	-5.4	-4.7	-4.5
Developing MENA	2.7	0.4	0.2	2.9	3.0	0.9	-1.2	-1.1	1.3	1.4	-2.8	-1.4	-3.7	-3.6	-3.6	-5.4	-4.4	-6.7	-6.1	-6.1
Oil Exporters	0.6	0.4	-0.3	2.0	2.3	-1.4	-1.4	-1.8	0.3	0.7	1.8	5.9	2.6	2.6	2.5	-6.1	-3.0	-5.1	-4.3	-4.1
GCC	-0.3	2.0	1.1	2.2	2.7	-2.4	0.1	-0.7	0.5	1.1	2.7	8.5	5.5	5.8	6.0	-7.2	-3.1	-4.2	-3.3	-2.8
Bahrain	3.8	1.8	1.8	2.1	2.3	-0.9	-3.0	-2.6	-1.5	-0.4	-4.5	-5.8	-3.6	-3.4	-3.7	-14.2	-11.7	-8.4	-7.7	-7.6
Kuwait	-3.5	1.2	1.5	2.5	2.8	-5.4	-0.2	0.3	1.2	1.4	6.5	15.0	9.0	8.6	8.9	-9.0	-3.0	-6.5	-5.9	-5.7
Oman	-0.9	2.2	0.3	3.5	4.0	-5.4	-1.9	-3.1	0.5	1.6	-15.3	-5.5	-7.7	-9.0	-7.0	-14.4	-7.9	-7.2	-9.4	-7.0
Qatar	1.6	1.5	2.0	3.0	3.2	-1.1	-0.6	0.2	1.2	1.5	3.8	8.7	4.3	5.3	4.8	-5.8	2.2	1.2	2.0	2.7
Saudi Arabia	-0.7	2.4	0.5	1.6	2.2	-2.7	0.6	-1.2	-0.1	0.6	1.5	9.0	5.8	7.1	7.9	-9.2	-5.9	-6.1	-4.5	-4.1
United Arab Emirates	0.5	1.7	1.8	2.6	3.0	-0.9	0.2	0.4	1.2	1.8	7.3	9.1	7.4	6.2	5.7	-1.6	1.2	-1.3	-1.0	-0.6
Developing Oil Exporters	2.1	-2.1	-2.8	1.8	1.7	0.4	-3.7	-3.8	0.0	0.0	0.3	1.4	-2.3	-2.4	-2.6	-4.2	-2.8	-6.7	-5.8	-6.0
Algeria	1.4	1.5	1.3	1.9	2.2	-0.3	-0.2	-0.3	0.4	0.7	-12.6	-6.7	-8.3	-10.7	-12.5	-8.8	-7.6	-12.2	-7.2	-7.1
Iran	3.8	-4.9	-8.7	0.1	1.0	2.6	-5.9	-9.6	-0.8	0.1	3.5	0.1	-0.6	-0.5	-0.3	-1.8	-5.4	-5.6	-5.9	-6.0
Iraq	-2.5	-0.6	4.8	5.1	2.7	-5.3	-3.3	3.9	1.5	-0.8	1.8	6.9	-4.6	-4.0	-4.0	-1.6	7.9	-4.6	-3.3	-3.1
Libya	26.7	7.9	5.5	-0.6	1.4	25.1	6.3	3.9	-2.0	0.1	11.7	23.0	13.6	7.3	4.5	-34.5	-7.6	-6.9	-9.7	-9.9
Yemen, Rep.	-5.1	0.8	2.1	2.0	..	-7.3	-1.6	-0.2	-0.3	..	-0.2	-1.8	-4.2	1.0	..	-5.3	-6.3	-6.8	-6.7	..
Developing Oil Importers	3.6	4.0	4.1	4.4	4.6	1.8	2.3	2.5	2.9	3.2	-8.1	-6.4	-5.8	-5.5	-5.2	-7.5	-7.4	-6.8	-6.5	-6.1
Djibouti	5.1	5.5	7.2	7.5	8.0	3.5	3.9	5.6	6.0	6.6	-3.6	14.9	16.0	18.8	22.4	-4.6	-2.8	-0.7	-0.5	0.8
Egypt	4.2	5.3	5.6	5.8	6.0	2.2	3.4	3.8	4.0	4.2	-6.1	-2.4	-2.6	-2.6	-2.6	-10.9	-9.7	-8.3	-7.5	-7.0
Jordan	2.1	1.9	2.2	2.3	2.5	-0.3	0.1	0.7	1.3	1.8	-10.6	-6.7	-6.4	-6.3	-6.5	-2.2	-3.3	-2.5	-2.4	-2.0
Lebanon	0.6	0.2	-0.2	0.3	0.4	-0.9	-0.3	-0.7	-0.2	-0.1	-22.7	-22.0	-20.8	-21.4	-21.3	-6.7	-10.7	-9.0	-9.8	-9.8
Morocco	4.2	3.0	2.7	3.5	3.6	3.1	1.9	1.6	2.5	2.5	-3.4	-5.5	-4.3	-3.7	-3.3	-3.5	-3.7	-3.6	-3.5	-3.4
Tunisia	1.8	2.5	1.6	2.2	2.6	0.7	1.3	0.5	1.2	1.6	-10.2	-11.2	-10.8	-10.7	-10.1	-6.2	-4.8	-5.3	-5.0	-4.7
West Bank & Gaza	3.1	0.9	1.3	-1.1	-0.4	0.4	-1.7	-1.3	-3.6	-2.9	-10.8	-11.4	-10.6	-9.9	-9.7	-3.5	-2.8	-12.4	-11.9	-11.4

Source: World Bank, Macro and Poverty Outlook, and authors' calculations.
 Note: e = estimate, and f=forecast. Data are rounded up to one digit. Data for Egypt correspond to the fiscal year (July-June). Syria is not included in the regional and sub-regional averages due to lack of data.

Table I.2. Revisions in Growth Forecasts between April and October 2019

Percentage points

<i>Real GDP Growth, percent</i>	<i>April Forecast</i>			<i>Difference (October 2019–April 2019)</i>		
	<i>2019f</i>	<i>2020f</i>	<i>2021f</i>	<i>2019f</i>	<i>2020f</i>	<i>2021f</i>
MENA	1.4	3.3	2.7	-0.8	-0.8	0.2
Developing MENA	0.8	3.5	2.6	-0.6	-0.6	0.4
Oil Exporters	0.9	3.1	2.2	-1.2	-1.0	0.1
GCC	2.1	3.2	2.7	-0.9	-1.0	0.0
Bahrain	2.0	2.2	2.8	-0.2	-0.1	-0.5
Kuwait	1.6	3.0	2.9	-0.1	-0.5	-0.1
Oman	1.2	6.0	2.8	-0.9	-2.5	1.2
Qatar	3.0	3.2	3.4	-1.0	-0.2	-0.2
Saudi Arabia	1.7	3.1	2.3	-1.2	-1.5	-0.1
United Arab Emirates	2.6	3.0	3.2	-0.8	-0.4	-0.1
Developing Oil Exporters	-1.0	3.0	1.4	-1.8	-1.2	0.3
Algeria	1.9	1.7	1.4	-0.6	0.2	0.8
Iran	-3.8	0.9	1.0	-4.9	-0.8	0.0
Iraq	2.8	8.1	2.3	2.0	-3.1	0.4
Libya	4.0	6.0	1.3	1.5	-6.6	0.1
Yemen, Rep.	2.1	10.0	..	0.0	-8.1	..
Developing Oil Importers	4.0	4.4	4.7	0.0	0.0	-0.1
Djibouti	7.0	7.5	8.0	0.2	0.0	0.0
Egypt	5.5	5.8	6.0	0.1	0.0	0.0
Jordan	2.2	2.4	2.6	0.0	-0.1	-0.1
Lebanon	0.9	1.3	1.5	-1.1	-1.0	-1.1
Morocco	2.9	3.5	3.6	-0.2	0.0	0.0
Tunisia	2.7	3.2	3.5	-1.1	-1.0	-0.9
West Bank & Gaza	0.5	1.0	1.6	0.8	-2.1	-2.0

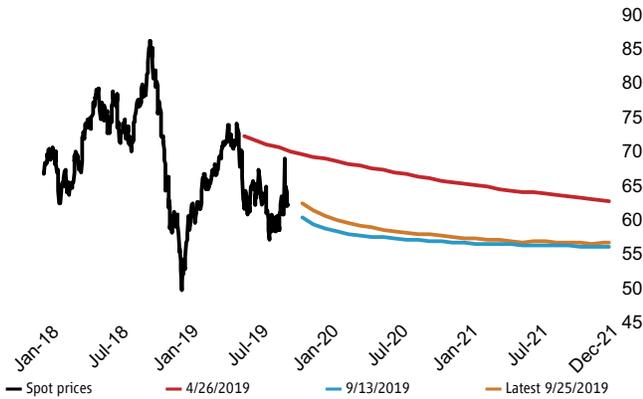
Growth Prospects for Oil Exporters

The benchmark Brent oil price started 2019 at about \$50-a-barrel and climbed to more than \$70-a-barrel by May, buoyed by voluntary supply cuts led by the Organization of the Petroleum Exporting Countries (OPEC) and Russia. Since then, pressed by a sluggish global demand and much uncertainty about prospects for the global economy, oil prices tumbled to mid-50s as of early September 2019 (see Figure I.2). The attacks on Saudi Arabia's oil facilities on September 14 sent oil prices up significantly at first. But prices retreated after Saudi Arabia promised recovery and oil supply uncertainty subsided.

The market expects oil price to hover around \$57 per barrel through the end of 2021. This projection is slightly higher than before the Saudi oil attack, due to concerns about supply, but is still below April's projection. More fundamentally, technology breakthroughs in shale oil and alternative energy production will likely keep oil prices low in the future. In the meantime, growth in global oil demand has steadily declined over the past few years (see Figure I.3). This poses fundamental challenges to both the short-term and long-term prospects for MENA oil exporters directly, and indirectly for MENA oil importers because of their economic connections with neighboring countries.

Figure I.2. Oil Price Forecasts

US dollars a barrel; expiration dates on x-axis



Source: Bloomberg, LP.
 Note: The black line indicates spot price of Brent crude oil. The colored lines illustrate the future prices of Brent crude oil on, respectively, April 26 when the last MENA Economic Update was produced, September 13 (the last trading day before Saudi Arabia's oil attack), and September 25, when futures prices converged to the level before the attack after Saudi Arabia announced sooner than expected recovery in oil production.

Figure I.3. Growth in Global Oil Demand

Percent, yoy

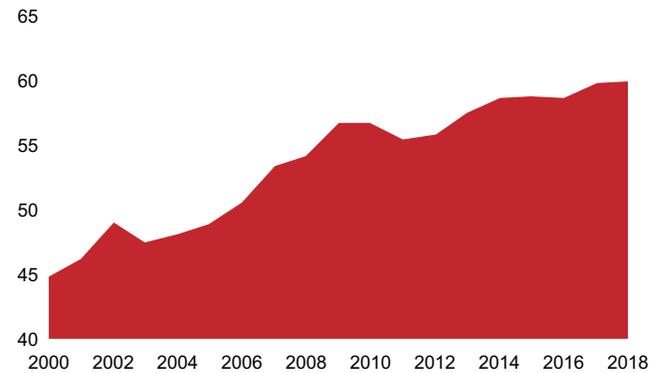


Source: International Energy Agency.

In the short-term, because of the dependence on oil and gas exports, GDP is expected to shrink 0.3 percent in 2019 among MENA oil exporters, compared to an already tepid 0.4 percent growth in 2018. The latest forecast is significantly lower than the 0.9 percent growth projected in the April 2019 MENA Economic Update. There are several reasons behind this pessimistic forecast. Iran's economy is contracting more sharply than expected. The voluntary production cuts led by OPEC took a heavy toll on MENA oil exporters. And oil prices have fallen sharply since May 2019, despite the production cuts, which further eroded oil export revenue. On the other hand, a boost in non-oil activities in the Gulf Cooperation Council (GCC) countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates), most prominently in construction, partially offset the dampening effect on the region's numbers from Iran's economic contraction.

Figure I.4. GCC's Non-Oil GDP Share

Percent



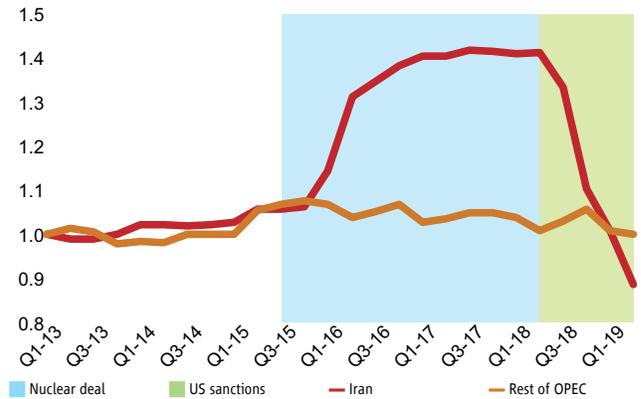
Sources: International Monetary Fund, World Economic Outlook database.

The GCC economies are expected to grow at 1.1 percent on average in 2019—below their 2.0 percent growth in 2018 and 0.9 percentage points lower than the April estimate. These downgrades largely reflect lower-than-expected oil revenue, due to oil production cuts⁶ and falling oil prices since April 2019. However, countries have made efforts to add economic activities other than oil (see Figure I.4). In Saudi Arabia—whose Vision 2030 blueprint seeks to diversify the economy—the Purchasing Manager's Index, which measures the health of the manufacturing sector, rose strongly during the second quarter, suggesting improving nonhydrocarbon activity. Economies in both the UAE and Qatar benefited from infrastructure projects related to Expo 2020 in the UAE and 2022 World Cup in Qatar. Construction, however, is winding down as preparations for the events near completion.

⁶ For example, Saudi Arabia's crude oil production in July 2019 is estimated at 9.65 million barrels per day, lower than the 10.7 million barrels a day in the fourth quarter of 2018 and lower than its pledged 10.3 million barrels per day (OPEC, 2019).

GDP in other developing oil exporters is projected to shrink by 2.8 percent in 2019, weighed down by Iran's economic contraction. The U.S. sanctions have severely affected Iran's oil production. Figure I.5 shows the dynamics of Iran's oil production (where output during the first quarter of 2013 is set at 1). After increasing by 40 percent following the 2015 nuclear deal, Iran's oil production fell sharply after the United States imposed sanctions in the second quarter of 2018. In May 2019, the United States ended waivers that allowed countries to import Iranian oil, further reducing Iran's oil production and exports. Oil production in Iran dropped to about 2.2 million barrels per day in June 2019, compared to 3.8 million barrels per day in early 2018 (OPEC, 2019). Since oil constitutes a major share of Iran's exports, real GDP in Iran is expected to contract further by 8.7 percent in 2019, 4.9 percentage point lower than the April 2019 forecast. The U.S. sanctions on Iran are also creating negative spillovers across MENA. Citing tensions in the region, the collapse of the Iranian currency and companies' fears of breaching the U.S. sanctions, the UAE projects that trade with Iran will fall by half in 2019, from \$19 billion last year (England and Kerr, 2019).

Figure I.5. Normalized oil production by Iran and by the rest of OPEC



Source: OPEC, Monthly Oil Market Reports.

Note: The lines show the dynamics of oil production for Iran and the rest of OPEC from Q1-2013 to Q2-2019. Oil production for Iran and the rest of OPEC are normalized to 1 in Q1-2013.

Following the end of the war and the formation of a new government, Iraq's economy is expected to grow at 4.8 percent in 2019. In Yemen, signs of macroeconomic improvements are emerging, with growth expected to pick up to 2.1 percent for 2019. However, risks remain high and the humanitarian conditions remain severe, with about three-quarters of the population in need of food aid and other forms of assistance.

Growth Prospects for Oil Importers

The overall macroeconomic environment in Egypt has improved following the country's exchange rate, fiscal, and energy reforms. Investment and natural gas output are growing. Tourism remains robust which helps the country's growth prospects. Growth during the first half of 2019 was robust at 5.4 percent, about the same as the 5.2 percent in the same period of 2018 (World Bank, 2019). Important changes on both the revenue and expenditure side—such as reductions in energy subsidies—have led to a gradual decline in Egypt's fiscal deficit, from 12 percent of GDP in 2016 to 9.7 percent in 2018 and an expected 8.3 percent in 2019.

Persistently large current account deficits and accumulated debt weaken Lebanon's economy. The economy is projected to contract by 0.2 percent in 2019. The deterioration on Lebanon's external side is accelerating. In the first five months of 2019, the economy's net foreign asset (NFA) position (the difference between foreign assets owned by Lebanese citizens and Lebanese assets owned by foreigners) decreased by \$ 5.1 billion (about 9 percent of GDP), compared to NFA losses of \$ 4.8 billion for all of 2018 and \$156 million in 2017 (Bank of Lebanon). The NFA position is a reflection of indebtedness, which shows up also as a decline in gross foreign exchange reserves. In response, the Bank of Lebanon (BdL) initiated financial operations to encourage the inflow of hard currency. This involves commercial banks soliciting dollar investors to place medium- (3-year) or long-term (10 year) deposits at high interest rates, which are then deposited at BdL, or used to invest in BdL certificates of deposit.

CHAPTER 2. OUTLOOK AND RISKS FOR 2020–2021

In the medium term, the World Bank expects real GDP in the MENA region to grow at 2.6 percent in 2020 and 2.9 percent in 2021. The projected pickup in growth is largely driven by increasing infrastructure investment in GCC countries and the recovery in Iran’s economy as the effects of the U.S. sanctions wane.

GCC’s economic outlook is stable, as oil prices are expected to hover around \$60 per barrel. Infrastructure investment is expected to increase further, and higher oil production will support greater growth in the six countries. On average, growth in the GCC is expected to reach 2.2 percent in 2020 and 2.7 percent in 2021. However, fundamental challenges persist as the countries remain dependent on oil exports, although discussions aimed at diversifying their economies have started to gain steam.

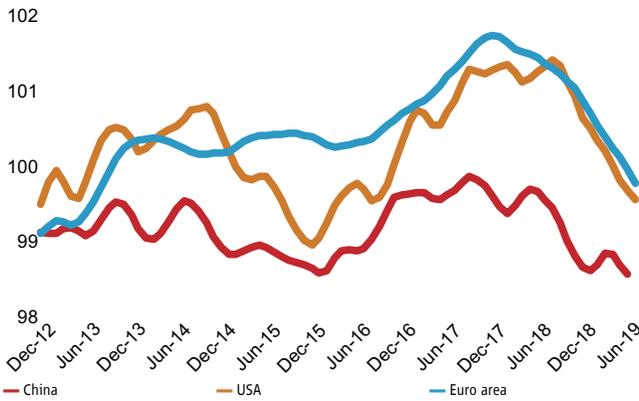
Iran’s economy is expected to bottom out and slightly recover in 2020 and 2021, assuming no further sanctions from the United States. Iran’s GDP growth is projected to be 0.1 in 2020 and 1.0 percent in 2021. However, the downside risks of escalating tensions with the United States, while not factored into the forecasts, cannot be ruled out. Iraq’s economic growth is expected to continue in 2020, peaking at 5.1 percent before decelerating to 2.7 percent in 2021. The country should spend prudently. The budget projects a 27 percent increase in spending year on year because of large increases in the public-sector wage bill, transfers, good and services, and allocations to the Kurdistan Regional Government (International Monetary Fund, 2019). A widening budget deficit would imply more limited resources devoted to reconstruction efforts and to buffering against a possible decline in oil prices.

GDP in Egypt is expected to continue to grow, reaching 6.0 percent in 2021—driven by improved domestic demand and export growth. Both private and public investment are expected to continue to grow, as planned investment projects in infrastructure and public works are implemented (World Bank, 2019a). Egypt’s elevated public debt remains of concern, although the debt-to-GDP ratio is projected to decline to 85 percent by the end of FY 2021 from 97.3 percent at the end of FY 2018.

MENA’s economic outlook is subject to substantial downside risks, most notably, intensified global economic headwinds and rising geopolitical tensions. Global economic activities continued to soften in the first half of 2019, with trade and manufacturing showing clear signs of weakness. In June 2019, World Bank economists revised global growth downward to 2.6 percent in 2019 (World Bank, 2019b), 0.3 percentage points below the January 2019 projection. Trade tensions are heightened. Technology tensions—such as the race to 5G technology between the United States and China—have also erupted, threatening the global technological supply chain and further undermining market confidence (see Figure I.6). In response, global monetary policy has shown signs of switching from tightening to loosening. Citing the gloomy prospects for the global economy, the U.S. Federal Reserve cut its short-term policy rate and has hinted there may be further adjustments, effectively ending a period of monetary tightening. The European Central Bank has also trimmed its rate and will resume its quantitative easing program. Yields on U.S. Treasury bonds are dropping (see Figure I.7), suggesting higher demand for safe assets and concerns about the global outlook⁷.

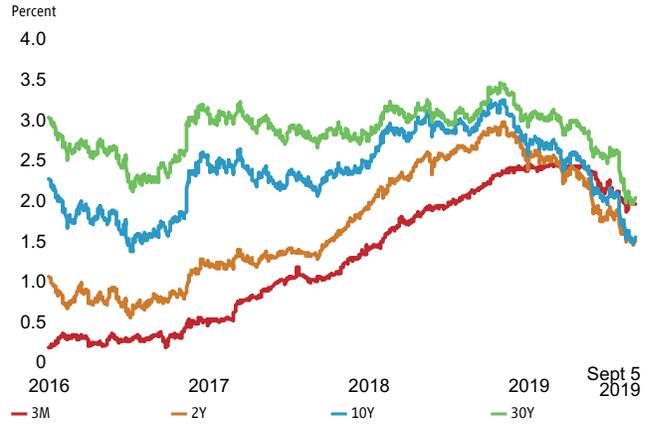
⁷ Yields on U.S. Treasury bonds have been declining since the end of 2018. Falling yields suggest investor demand for safe assets, exemplified by U.S. Treasury securities, is growing, which drives up prices and pushes down yields. Moreover, yields on longer-term U.S. Treasury bonds have been declining relative to shorter-term Treasury securities, resulting in an inverted yield curve (when short-term rates are above long-term rates). Long term rates are normally higher than short term rates because of the risks. An inverted yield curve is usually observed before a recession because it reflects investor concerns about the longer term, which causes them to seek long-term, stable, risk-free assets—such as U.S. Treasury bonds.

Figure I.6. Business Confidence in China, the U.S. and Euro Area



Source: OECD.
 Note: Numbers above 100 suggest an increased confidence in near future business performance, and numbers below 100 indicate pessimism towards future performance.

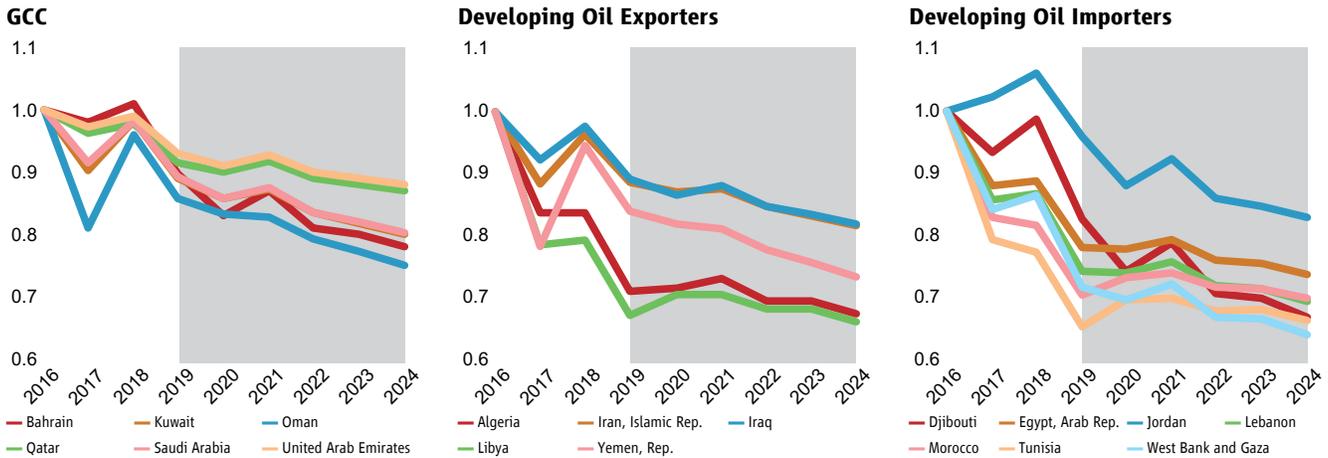
Figure I.7. Yields for U.S. Treasury Bonds



Source: Bloomberg; LP.

The slowdown of the global economy has already started to affect MENA, mainly through falling oil prices—which hurts export revenue of oil exporters and complicates their spending decisions. A further slowdown of the global economy, or worse, a global recession, would significantly affect MENA as external demand would severely weaken and oil prices would plunge. Figure I.8 shows estimates of weakening growth in export demand for MENA in 2019 and beyond⁸. Moreover, global financial volatility associated with slower growth would also worsen the ability of MENA countries to borrow, or, worse, could trigger capital outflows from highly indebted countries, such as Lebanon.

Figure I.8. Expected Growth in Export Demand for MENA



Sources: UN Comtrade; International Monetary Fund, World Economic Outlook database; and World Bank staff calculations.

Geopolitical tensions in the region, which have been rising since the April 2019 Update, were heightened on September 14 after the attack on two major oil facilities in Saudi Arabia. Worsening geopolitical tensions could bring further

⁸ The expected growth in export demand for each MENA country is proxied by the weighted average of expected growth in its trading partners' domestic demand based on projections in the World Economic Outlook. The weight is the share of the MENA's country exports to the partner as a fraction of the country's total exports in 2016. The major trading partners are the U.S., China, EU and India. The index is then normalized to 2016.

disruptions to global oil production and prices and threaten the already fragile stability of both the region's and the world's economy. A further escalation in the tension between the United States and Iran could severely weaken Iran's economy and spill over to other countries in the region. While rising oil prices would benefit many oil regional exporters in the short run, the overall impact would be to hurt regional trade, investment, and infrastructure. For example, Iraq relies heavily on electricity and gas imports from Iran, so worsened U.S.-Iran relations could threaten Iraq's energy security.

Part II: Promoting Fair Competition in the Middle East and North Africa

CHAPTER 1. THE FOUNDATIONS OF FAIR COMPETITION

The chapter discusses the rationale for promoting fair⁹ competition across the MENA region and the necessary accompanying institutional framework. First, it looks at the content of competition laws and highlights the need for independent and accountable authorities. It then considers the role of the judiciary (and more broadly of the rule of law) in ensuring the effectiveness of antitrust laws. Finally, the experiences of five MENA countries (Egypt, Jordan, Kuwait, Saudi Arabia and Tunisia) are described in detail.

1A. Making MENA Markets Competitive¹⁰

Economies in the Middle East and North Africa (MENA) have two faces. One is the concentrated and sclerotic formal sector, often dominated by state-owned enterprises (SOEs) and politically connected private companies. That economy keeps out competitors, misallocates resources, and generates excessive profits for participants. The official economy coexists with an informal economy in which most of the population toils in relatively small operations at low wages and with few social protections.¹¹

A powerful way to invigorate MENA economies would be to inject more competition. That would create a more efficient official economy and reduce informality.

Economists suggest that *competition* is a powerful tool for ensuring that resources are used in the best way that is technologically feasible—minimizing costs (and therefore prices) and helping ensure that goods and services are provided in the amount and variety consumers desire. As firms compete against each other to make a profit, they have an incentive to invest in research and development to improve the production of existing goods and services and to introduce new ones¹². More competition also leads to higher growth in output per worker (productivity) and therefore is a key ingredient in long-run sustainable development¹³.

Market entry by new firms and the exit of inefficient companies are potent sources of competition. But in the MENA region there are often sizeable barriers that prevent new firms from entering existing markets and protections for

⁹ Here the term “fair” is used to describe competition that offers equal opportunities to insiders and outsiders. It is a different use from the notion of “fair competition” that might be contained in Commercial laws which relate to the use of trademarks or to advertisement.

¹⁰ This section was authored by Andrea Barone. Box II.1 was authored by Rabah Arezki, and box II.2 was co-authored by Rabah Arezki, Rachel Yuting Fan and Ha Nguyen.

¹¹ See World Bank (2009), Diwan and others (2015) and Rijkers and others (2017).

¹² See Motta (2004).

¹³ See Kitzmuller and Licetti (2012).

inefficient ones. Ease of entry and exit is what determines *contestability*, and it is the result of the interplay between the available production technology and the regulatory framework in place.

Moreover, when state-owned enterprises (SOEs) are present, it is fundamental that they do not benefit from any type of advantage over their private competitors—whether by obtaining specific inputs (physical or financial) or by receiving easier market access. In brief, the institutional framework must be geared towards the principle of *competitive neutrality*—that all enterprises face the same set of rules whether they are public or private and that government involvement or ownership of a firm confers no special advantage.

Competition and contestability are essential to creating **economic opportunity**, which allows workers to help shape their destiny through personal initiative. Competition also increases the purchasing power of incomes, because firms find it harder to set prices above cost. Moreover, these effects are reinforced through cost-reducing technological progress and firm turnover, which allows the most productive firms to survive¹⁴. The overall effect is that competition can be an *antidote to inequality*¹⁵. As Eleanor Fox put it: “Markets empower people to help themselves. Markets and access to markets stand side by side with food, health, shelter, education, environment, infrastructure, and institutions as critical tools to combat the world’s greatest economic deprivations”¹⁶. But, as the father of modern economics, Adam Smith, recognized in *The Wealth of Nations*, a well-functioning competitive process cannot be taken for granted¹⁷.

That means countries must undertake policies that foster competition. Those policies include an effective antitrust law that keeps in check restrictive practices of the private sector and of government interventions to preserve a level playing field—which means that any regulation that distorts markets in pursuit of the general interest¹⁸ should not create any unnecessary barriers. But it also means that when state owned enterprises (SOEs) are present or subsidy programs are involved, competitive neutrality should be ensured for all market participants (see Figure II.1).

In 1890, the United States recognized that legislation was needed to preserve and nurture competitive forces by passing the Sherman Act. The law was a reaction to the dangerous concentration of economic and political power in large companies and trusts that characterized the so-called Gilded Age¹⁹. Since then, almost every country has adopted some form of competition law, with a substantial acceleration during the past few decades²⁰.

In the MENA region, four countries lack antitrust legislation—Iran, Lebanon, Libya and West Bank and Gaza—while Bahrain and Iraq have no competition authority to enforce their law (see Table II.1).

14 See World Bank (2017) par. 1.2 pp. 7-10 for a discussion of these mechanisms.

15 See Khemani (2007), Baker and Salop (2015) and Ennis and others (2017).

16 See Fox (2017) p. 37.

17 Smith’s assertion that “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices” has become familiar to the general public.

18 For example, when minimum quality requirements are set for the supply of a good.

19 In US history, the ‘Gilded Age’ corresponds to the period from the end of the Civil War in 1865 until the end of the 19th century, which was characterized by the emergence of powerful monopolies in many sectors (the so-called Trusts) and extreme and rising inequality. An account of the era is offered by White (2017).

20 The US Federal Trade Commission lists 218 countries that have a public body in charge of competition policy, most of which are independent authorities. Moreover, the FTC lists nine regional organizations that deal with antitrust. See <https://www.ftc.gov/policy/international/competition-consumer-protection-authorities-worldwide>.

Figure II.1. A Comprehensive Competition Policy Framework

Pillar I: Procompetition regulations and government interventions: opening markets and removing anticompetitive sectoral regulation	Pillar II: Competitive neutrality and non- distortive public aid support	Pillar III: Effective competition law and antitrust enforcement
Reform policies and regulations that strengthen dominance: restrictions to the number of firms, statutory monopolies, bans towards private investment, lack of access regulation for essential facilities.	Control state aid to avoid favoritism and minimize distortions on competition.	Tackle cartel agreements that raise the costs of key inputs and final products and reduce access to a broader variety of products
Eliminate government interventions that are conducive to collusive outcomes or increase the costs of competing: controls on prices and other market variables that increase business risk.	Ensure competitive neutrality including vis-a vis SOEs	Prevent anticompetitive mergers
Reform government interventions that discriminate and harm competition on the merits: frameworks that distort the level playing field or grant high levels of discretion		Strengthen the general antitrust and institutional framework to combat anticompetitive conduct and abuse of dominance

Source: World Bank and OECD (2017), elaborated by The World Bank Group Markets and Competition Policy team.

Extensive information exists about the competition frameworks of seven MENA countries—Algeria, Egypt, Jordan, Kuwait, Morocco, Oman, and Tunisia²¹. The evidence shows that they lack key elements of effective regimes, placing substantial costs on their economies. In addition, weak enforcement is a major problem. Its importance is demonstrated by the increase in the value of the divested assets that followed successes in breaking up market concentration.

The breakup of Standard Oil in the United States is a vivid example. When the U.S. government sued Standard Oil in 1906, the company controlled more than 90 percent of U.S. oil refining. After the courts broke Standard Oil into 34 entities in 1911, their combined stock value increased so rapidly that a few years later it was five times higher²². Such an experience is relevant for the MENA countries, where many economic sectors are dominated by few companies even though there are no technological reasons for such a level of market concentration. A striking example is exclusive import licensing for goods for which countries are not self-sufficient (see Box II.1).

²¹ This analysis is based on the updated (August 2019) questionnaire compiled for the MENA Development Report “Privilege-Resistant Policies in the Middle East and North Africa”. See Mahmood and Ait Ali Slimane (2018), pp. 77-98. For more detailed descriptions of the competition frameworks of Egypt, Jordan, Kuwait, Morocco, Saudi Arabia and Tunisia see Section 1C “MENA Countries Vary their Approach to Ensuring Competition.”

²² See Wu (2018) p. 68. The irony of the breakup is that John D. Rockefeller, who controlled Standard Oil, was a major beneficiary of the dissolution of the trust; even incumbents can benefit from less concentration.

Table II.1. MENA Competition Laws and Competition Agencies

Country	Competition Law	Date of enactment	Amendments	Date of creation of Competition Authority
Algeria	Yes	1995	2003, 2008 and 2010	1995; no activity 2003–13
Bahrain	Yes	2018	-	no authority
Djibouti	Yes	2008	-	2008
Egypt	Yes	2005	2010 and 2014	2005
Iran	No	-	-	-
Iraq	Yes	2010	-	no authority
Jordan	Yes	2002	2011	2002
Kuwait	Yes	2007	2012	2012
Lebanon	No	-	-	-
Libya	No	-	-	-
Malta	Yes	1994	2000, 2003, 2004, 2011, 2012 and 2017	n.a.
Morocco	Yes	2000	2014	2008; no activity 2014–18
Oman	Yes	2014	2018	2018
Qatar	Yes	2006	-	Yes
Saudi Arabia	Yes	2004	2014, 2019	2004
Syria	Yes	2008	-	2008
Tunisia	Yes	1991	1995, 2003, 2005 and 2015	1995
United Arab Emirates	Yes	2012	-	n.a.
West Bank and Gaza	No	-	-	-
Yemen	Yes	1999	-	2007

Source: Adapted from Youssef and Zaki (2019).

Notes: n.a. = not available. Competition provisions included in laws, codes or international treaties that do not articulate a comprehensive national competition regulatory framework have not been considered as existing "competition laws." Limited powers granted to ministerial departments to review competition issues or to other public bodies whose main function is not competition enforcement have not been considered as existing "competition authorities."

Box II.1. The Curse of Monopolized Imports

Raúl Prebisch famously argued that developing countries should replace imports with domestic production because of the potential gains in industrialization that would stem from such import substitution. In the strategy advocated by the late Argentinian economist, the state would play a central role by nationalizing companies, subsidizing domestic producers, and setting tariffs and subsidies.

Prebisch-like development strategies gradually fell into disgrace during the debt crises near the end of the last century. Instead, the export-driven success of Asian economies like Korea shifted the focus of the economic development paradigm from discouraging imports to stimulating exports. That change in emphasis from imports to exports was predicated on both the catalytic effect on domestic production of exposure to global competition and the transfer of technology that stems from foreign direct investment. As the development paradigm shifted, so did policies—from those promoting trade to support domestic industries to those aimed at turning developing countries into platforms for multinational corporations in order to integrate into global markets.

For countries in the Middle East and North Africa (MENA), export-led development strategies have had little success, although instruments of the earlier import-substitution strategy—such as state-owned enterprises, high tariffs, and subsidies—have survived. Instead of fostering domestic production as Prebisch envisioned, however, these legacies have created a crony-capitalistic monopolization of imports that has limited the level of competition

continued on next page

Box II.1 continued

in many sectors of the economy and furthered the dependence on imports. Episodes of liberalization ended up transferring ownership from state to private monopolies. What is more, competition authorities—still in their infancy in MENA—have had little space to level the playing field among private sector actors and stop collusion among companies, including foreign and state-owned ones.

Besides tariffs, which are taxes on imports, restrictions can include quotas (limits on import quantities) and constraints on the purchase and sale of foreign currency. In MENA countries, these barriers have had the detrimental effects of fostering an import lobby that distorts market incentives, of reinforcing an inefficient subsidy-based private sector, and of causing higher prices for tradable goods. Several issues emerge from exclusive import licenses:

First, *agents that benefit from the import “industry” constitute the biggest lobby against domestic production.* For example, exclusive import licenses grant a monopoly on imports to an individual or a national agency. These licenses discourage potential domestic production. Indeed, licenses—and the monopoly power associated with them—increase the domestic price of imports and import-competing goods, thereby increasing costs of producers who buy these imports (or substitutes) as inputs. Auctions to allocate import licenses with expiration dates are a good approach to taking on importer monopolies. Auctions could limit the capture of excess profits by non-deserving agents and result in, at the very least, lower prices and costs to downstream users and consumers.

Second, *universal subsidies reinforce the distorted structure of the economy toward import dependence.* Subsidies on imports such as food or basic goods increase demand for them. Moreover, the subsidy artificially increases the demand for the products of the exclusive importers and can cost the government a lot of money that could be spent elsewhere. Profits from oil exports or foreign aid have funded the universal subsidies that support the monopolization of imports. When government purchases are relatively large, the potential for quid pro quo corruption with private actors is large. The agriculture and agribusiness sectors epitomize distorted competition between local production and (monopolized) imports in presence of consumer subsidies. There are, of course, other impediments to the development of agriculture to serve domestic demand, but ending monopolized imports and substituting targeted subsidies for the universal variety would help farm sectors meet domestic needs.

Third, *import dependence leads to persistent twin deficits; that is, a budget deficit drives the trade deficit.* Imports of universally subsidized goods are often smuggled into other countries or used as an input in an industry that as a result gains an artificial advantage—such as the soft drink industry, which benefits from subsidized sugar. It is especially the case when the government buys and sells the import. Liberalizing imports and associated logistic and distribution chains, and cutting subsidies, would help resolve the persistent deficits that have plagued the MENA region in recent years. Unless those deficits shrink, citizens may be asked to face drastic cuts in transfers or social services to preserve the rents of a few non-deserving oligarchs.

Moreover, strong antitrust action can unleash substantial technological advancement, as suggested by two landmark U.S. cases—against IBM and Microsoft²³. The IBM case effectively opened the software industry by forcing IBM to stop selling computers and software as a package.²⁴ The Microsoft case in 2001 likely kept the Seattle-based giant from trying to monopolize the nascent new economy by preemptively crushing companies such as Amazon, Facebook and Google (as it did to the competing web-browser Netscape, which sparked the antitrust action).

²³ See Wu (2018), especially pp. 98-101 and 110-114, and Wu (2019).

²⁴ If they could not sell hardware and software separately, start-ups would have had to supply both to compete effectively, a sizeable entry barrier.

Lack of contestability in MENA is arguably a main culprit in the slow pace of technology adoption that has historically characterized the region, which significantly hurt its growth performance. Without substantial reforms to encourage competition, MENA countries risk missing the opportunities offered by digitization and the so-called Fourth Industrial Revolution (See Box II.2).

Box II.2. MENA's Failure to Adopt General Purpose Technologies

The rapid pace of technological change, dubbed the "Fourth Industrial Revolution," offers new opportunities for the Middle East and North Africa (MENA) that the region cannot afford to miss. The fourth Industrial revolution encompasses new technologies that mesh the digital, physical, and biological worlds (for example, robots, artificial intelligence, machine learning, gene editing). It has affected the way all sectors and economies work and allocate resources.

MENA must embrace this technological revolution if it is to leapfrog into the future. While MENA may have missed the earlier boat on industrialization, the countries in the region have made extensive investment in the health and education of their citizens who can be the source of the creativity and skills needed to drive a new economy. Young people have been quick to adopt new technology, and the uprisings during the "Arab Spring" showed how adept they were with social media. Yet to unleash the transformative effect of technology, the mobile devices that are in nearly every pair of hands need to become more than instruments to communicate grievances. They need to become tools to innovate, launch businesses, and create new opportunities.

Unfortunately, MENA is not well positioned to adopt new technologies and innovate. Arezki and others (2019) used empirical evidence on past and current adoption of general-purpose technologies (GPT), to show that MENA does not perform well in technology adoption. Based on seven measures of technology, new and old, MENA's pace of adoption is always slower than the other countries with similar incomes. The measures are bandwidth per internet user (bits per second); number of self-contained computers designed for use by one person; internet users as a percentage of the population; the number of ATMs per million persons; the number of payments by credit and debit cards per million persons; the number of tractors used in agriculture per million persons; and gross output of electric energy per million persons.

The relatively slow pace of technology adoption in MENA could be explained by barriers to entry (or lack of contestability) in the region's telecom and finance sectors, the two key general-purpose sectors. With lower contestability there are fewer newcomers to challenge incumbents and push technology adoption. Arezki and others (2019) use market concentration to proxy for the lack of contestability—that is the higher the market concentration the more severe is the lack of contestability. They find that compared to the same sectors in other economies with the same income, market concentration for mobile operators and banking in MENA increases significantly faster as income rises. This evidence is consistent with a popular notion that MENA does not fare well in market competition. According to the World Bank's *Doing Business 2019* data at <https://www.doingbusiness.org/>, MENA countries are generally ranked very low in starting a business—for example, Egypt is 109 out of 190; Saudi Arabia, 141; Algeria, 150; Iraq, 155.

Missing out on the Fourth Industrial Revolution would leave the MENA region on the wrong side of the digital divide. The region would be excluded from the global value chains of goods and services. Without the cloud and the access to the latest software it provides, start-ups and small enterprises would be less competitive. People in less-developed economies would be left without infrastructure that links them to opportunities or forced to travel in search of them. On balance, the returns on digitization are potentially higher for developing economies. The MENA region is in position to reap its rewards. It will require changing regulations that favor incumbents, and creating competitive economies driven by innovation. This is the only formula capable of meeting the aspirations of the region's youth.

European Union (EU) competition policy resonates in the MENA region for two main reasons:

First, *in Europe, as in MENA countries, the state has traditionally played a major role in the economy.* It was made clear at its founding that EU competition law would apply to SOEs when they operated in markets in which they did not have a legal monopoly. Indeed, the EU courts developed the so-called functionalist approach—that is, the type of economic activity engaged in, not the entity engaging in it, determined whether antitrust law applied. Across-the-board enforcement is essential for MENA too, but exemptions from the application of competition law are common across the region (see Table II.2).

Table II.2. Sectors Exempted from Competition Law in MENA

	Algeria	Egypt	Jordan	Kuwait	Morocco	Oman	Tunisia
Conduct that is required or authorized by other government authority	X	X	X		X		X
Certain sectors of the economy	X			X	X	X	X
Legal monopolies	X			X	X		X
Certain goods or services	X	X	X	X	X	X	X
Other state bodies and government agencies		X		X		X	
State owned enterprises		X		X		X	

Source: This analysis is based on the updated (August 2019) questionnaire compiled for Mahmood and Ait Ali Slimane (2018), Chapter 2. Competition Policy pp. 77-98.

These exemptions have a deleterious impact on competition. Algeria, Egypt, Jordan, Kuwait, Morocco and Tunisia all reserve the right to fix the price of certain goods if supply conditions require it, eliminating competition altogether to achieve social goals. Moreover, restrictive agreements and practices that derive from the application of the law are not covered by the antitrust provisions in Algeria, Egypt, Jordan, Morocco and Tunisia, while legal monopolies can be authorized in Algeria, Kuwait²⁵, Morocco, and Tunisia. In Morocco professional associations can ask for authorization to provide pricing guidelines to members. In Egypt and Oman utilities that are run directly by the state are exempted and in Kuwait any type of SOE can be placed outside the scope of the competition law.

Second, *by conferring supranational enforcement powers on its Directorate for Competition, the EU can tame big companies more effectively than national antitrust authorities could have done by themselves,* given the pressures they would have inevitably faced. For example, earlier this year, the EU blocked the proposed merger of the French and German national champions Alstom and Siemens, despite strong support for the merger by both countries²⁶.

The MENA region is the least integrated in the world, so domestic companies are forced to inefficiently serve relatively small markets. Much like what happened during the European integration process, the reduction of trade barriers in the area could help firms expand production by exporting to their neighbors, allowing better exploitation of both economies of scale and scope. Each country could find its comparative advantage and take full benefit of the region's growing population, which is projected to almost double by 2050. But incumbent firms would surely fight this, requiring that a pan-MENA antitrust enforcer would have to be part of any economic integration²⁷.

²⁵ The oil sector by law is outside the scope of the competition law.

²⁶ See Motta and Peitz (2019).

²⁷ In this respect, Egypt, Libya and Tunisia are already members of COMESA, the Common Market of Eastern and Southern Africa, while the GCC countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates) have had a common market since 2008. Both regional groups have begun to consider developing a cross-country competition framework. On COMESA, see Fox and Bakhom (2019) pp. 133-139.

Box II.3. Digital Dilemma: Regulating the New Internet Economy Is Difficult

The digital economy, driven by data and multisided platforms, poses new problems for regulators.

The *availability of data* affects the level of competition. For example, if an outside supplier wants to offer a service to complement the main offering of an existing digital company, it needs access to data about that main offering (such as the myriad apps available through Apple). Data availability also affects economic development because the more data there is, the more experimentation and improvement can occur. If an incumbent firm denies data access to outside suppliers and potential competitors, the incumbent might violate antitrust laws. But deciding whether this is the case depends on specific market details and the intended uses of the data. Moreover, because litigation could take years, regulation is a more expeditious way to determine whether there is a violation. But in granting access to potential competitors, regulators must also preserve individual privacy and minimize the negative impact on incentives to invest in data collection.

Multisided platforms don't engage in proprietary activity. Instead they provide a digital venue for buyers and sellers of a service to enter into an exchange. Amazon and its Middle East subsidiary Souq, for example, are digital marketplaces that link retailers and consumers. Apps such as Careem link ride-seekers and drivers, while Airbnb matches up those willing to rent accommodations on a short-term basis with potential tenants. Social media sites, such as Facebook, allow individuals to interact among themselves and access content, and permit advertisers to reach those individuals. For each side, the utility of the multi-sided platform increases with the number of agents on the other (for example, on a commerce platform, consumers benefit from having many retailers to choose from and retailers like a large pool of potential customers). Moreover, each group would be unable to negotiate with the other because of excessively high transaction costs. The platform decides the prices and will subsidize the side that generates the largest benefits and charge the other side(s). This is apparent in the platforms that offer services at no monetary cost and earn all their revenue from advertising—including search engines and social media. Of course, the services are not free to users; they pay by giving away personal data in ways that they may not fully understand. In addition, the value of the services of some platforms, such as social media, increases with the number of users of the same type; the more people are connected, the larger is the probability that one user will find another with whom they want to communicate. Finally, platforms have much higher fixed than variable costs, so the revenue from adding a new member far exceeds the cost.

The economics of data and multi-sided platforms results in substantial entry barriers, leading to extremely concentrated markets with a strong advantage to incumbents. Moreover, they constrain competition. For example, new entrants usually cannot directly take on the incumbent platform but must start on a small scale by offering new complementary services—possibly through the platform itself. As a result, new entrants compete among themselves rather than with the platform. Only if they become successful and attract a sufficiently large user base might they try to expand from the original niche, adding more services to their portfolio and become a competitive threat for the incumbent platform. The natural reaction of the incumbent is either to buy the new entrant or add its own version of the newcomer's innovation to the main service.

It is important, then, that competition authorities seek to preserve opportunities for newcomers to fairly compete with incumbents. They must monitor anticompetitive behaviors and practices of dominant platforms—including tying all its services and eliminating stand-alone versions. Moreover, since high entry barriers protect incumbents, they have an incentive to shape the platform rules to their own advantage, possibly stifling competition on the platform itself (for example, by giving special treatment to affiliated services) or directly exploiting consumers by declining much responsibility if an interaction on the platform goes wrong. These problems originate from the platforms' dual roles as gatekeepers (they decide who can access it) and quasi-regulators (they determine the rules that users must follow to interact among themselves) and could lead to potentially serious antitrust infringements.

Part of the future growth strategy for the MENA region should be based on harnessing the digital economy²⁸. While holding much promise, the new economy also poses substantial issues in preserving competitive forces (see Box II.3). Without an effective competition policy framework capable of undertaking strong enforcement actions, the region stands to forfeit most of the anticipated economic gains and also risks falling victim to a new form of colonization by foreign tech giants. In this respect, Uber’s purchase of the ride-hailing startup Careem or Amazon’s acquisition of the marketplace Souq might end up being considered missed opportunities for local development.

▸ A good competition law

At its most basic level, a competition law must prevent big companies from adopting abusive tactics aimed at eliminating smaller efficient rivals (say through predatory pricing or imposing exclusive requirements on distributors). In addition, firms must be prohibited from fixing prices and sharing markets²⁹, which effectively amounts to stealing from consumers. Moreover, the law should mandate review (with potential blockage) of the largest mergers to prevent anticompetitive behavior.

The law should then create a specialized enforcement body—a **competition authority**—with a clear mandate to tackle all possible anticompetitive behavior in every economic sector, irrespective of the type of economic entities concerned and a full set of powers—such as subpoena and surprise inspections—to obtain the information it needs³⁰, to punish serious violations of the law, and to establish a constructive dialog with all through advocacy actions. At the same time, the law should allow the agency full discretion to use its technical expertise to take the best action based on the details of the specific problem. Other supervisory agencies should also seek to assure competitive behavior in sectors they oversee (see Box II.4).

Box II.4. The “Complementary” Supervisory Agencies

In addition to competition authorities, different types of supervisory agencies also may seek to assure competitive behavior. They include:

Sectoral regulators, which are created to supervise network industries (energy, telecoms, transport, water) where there is a natural monopolistic element. Sectoral regulators define the rules for accessing the network by all service providers to prevent discrimination, provide dispute settlement mechanisms (between rival companies and between the companies and consumers), monitor quality and the respect of universal service obligations (see Kessides, 2004).

Consumer protection agencies, which enforce rules prohibiting deceptive advertising and unfair trading practices. For example, they require firms to provide clear information about the goods and services they sell and that their sales practices do not unduly influence consumer decisions. More stringent provisions are set to protect vulnerable groups, such as children, sick people, and the elderly.

continued on next page

²⁸ See Arezki and others (2018).

²⁹ And, in the public procurement context, bid rigging.

³⁰ Competition authorities (as any regulator) are at an informational disadvantage with respect to firms.

Box II.4 continued

Data protection administrations deal with privacy law, which tries to enable individuals to control how their personal data is collected, processed and disseminated by public and private organizations with which they interact.

Agencies must be careful to impose proportional penalties and remedies, so that well-intended actions to protect consumers do not become entry barriers that overly affect start-ups.

The duties of various types of agencies can be assigned in different ways, spread among various agencies or consolidated depending on the country. The so-called concurrency system entrusts competition enforcement to the regulators in the respective industry. The concurrency model is used in Algeria for telecoms, energy, transport and banking, and in Egypt and Jordan for telecoms (see Mahmood and Ait Ali Slimane, 2018).

In the seven MENA countries considered, competition laws cover all types of infringements and also confer advocacy powers to the authorities. The only notable exception is the absence of merger review in Egypt, where unlawful transactions can be assessed only through the provisions prohibiting anticompetitive agreements. This means that the agency can act only after a merger is consummated,³¹ which reduces the effectiveness of any action unless firms cooperate. All competition authorities in the MENA countries can submit opinions about the impact on competition of government policies, draft legislation, and regulations but their conclusions are not binding and, in Tunisia the agency can weigh in only if requested by the Ministry of Commerce.

In countries with competition authorities, the agencies can request information, conduct surprise inspections, and seize documents. Nevertheless, the Tunisian authority cannot issue summons or subpoenas when a company under scrutiny fails to cooperate. Moreover, a leniency program that grants cartel participants immunity from sanctions in exchange for a confession and active cooperation in the investigation is a powerful instrument that is available only in Egypt, Morocco and Tunisia (see Table II.3).

Table II.3. The Powers of Competition Authorities in MENA

	<i>Algeria</i>	<i>Egypt</i>	<i>Jordan</i>	<i>Kuwait</i>	<i>Morocco</i>	<i>Oman</i>	<i>Tunisia</i>
Requesting parties to voluntarily provide information	X	X	X	X	X	X	X
Issuing a summons or subpoena	X	X	X	X	X	X	
Conducting unannounced raids (search and seizure) and inspections	X	X	X	X	X	X	X
Market studies	X	X	X	X	X		X
Law enables a fine of up to 10% of annual turnover		X			X	X	X
Powers to impose fines directly	X				X		X
Leniency programs		X			X		X

Source: This analysis is based on the updated (August 2019) questionnaire compiled for Mahmood and Ait Ali Slimane (2018), Chapter 2. Competition Policy pp. 77-98.

³¹ The Egyptian Competition Authority requires that it be notified.

▸ A good antitrust authority

The quality of the enforcer is as important as the enabling legislation itself. Indeed, the best rules are meaningless if the agency in charge of their application is ineffective. Scientific research and practitioners' reflections have given rise to a large literature³² on the design of competition authorities (and more broadly of market regulators), highlighting a set of key features that must be in place to ensure professional and nonpartisan enforcement based on solid economic and legal considerations. In this way, it is possible to reach an acceptable balance between effectiveness and legal safeguards for both firms and consumers.

There are two overarching principles of *independence* and *accountability* that are the opposite sides of the same coin. These principles must not only apply to the entity entrusted with the competition mandate, but also to the courts that review its decisions. Indeed, it would be pointless to have a world class agency if its decisions can be overturned by shoddy judges (see section 1B "Competition and Rule of Law Go Hand-in-Hand").

Independence is necessary to ensure that the competition authority can make fact-based, impartial decisions free from undue government or private sector pressure. In this way, the agency can create a true level playing field for all firms regardless of how powerful their owners are. Many factors influence the degree of autonomy effectively enjoyed by the competition authority.

Structural separation from line ministries is essential and the government should not have veto power over individual decisions. In *appointing the head and the board of the competition authority*, inevitable political involvement must be restrained through an open and transparent selection process that requires proven expertise from the candidates; establishes relatively long (five-to-seven year), non-renewable, fixed terms with dismissals limited to objective personal malfeasance (such as conflict of interest or seriously inappropriate behavior); prohibits board members from holding other positions while in office, and restricts their behavior for a certain time after their tenure ends (commonly called a "cooling-off period").

In addition, the agency should *be able to set its own priorities and use its human and financial resources as it sees fit*. Having a large enough budget that allows it to recruit and retain qualified staff is a safeguard against capture by special interests. Moreover, the budget should be multiannual and rely on a mix of sources (public funds, mandatory contributions from firms with sufficiently large turnover, fees for merger reviews, and a fraction of the fines levied). Each funding source differently affects the degree of independence and accountability of the antitrust agency. For example, if public funds are a major component of the budget, there is an increased risk of political interference. Conversely, if overall resources depend heavily on the fines levied, a potentially dangerous prosecutorial bias could emerge. These risks would be mitigated in systems in which investigation and adjudication are separated. Capture risks could increase in systems with mandatory firm contributions where only a few companies (possibly SOEs) would be subject to the levies.

In almost all the seven MENA countries, the antitrust agency is separate from any line Ministry. The exception is Jordan, where a Competition Directorate is inside the Ministry of Industry Trade and Supply.

³² See, among others, Kovacic (2009), Kovacic and Hyman (2012), Hyman and Kovacic (2013a), Hyman and Kovacic (2013b), Jenny (2016) and Ottow (2015).

Still there are many ways competition bodies are weakened. In all cases the President and the board members are nominated by the executive branch and in many countries some seats are designated for specific categories: high magistrates in Algeria, Morocco and Tunisia; representatives from the government in Egypt, Jordan and Morocco; individuals from industry associations in Egypt, Jordan, Morocco, and Tunisia; and from consumer bodies in Egypt and Jordan. The presence of these designees weakens the level of independence of the authorities in MENA.

The length of appointment varies from two to five years and board members can be renewed at least once (apart from the industry representatives and the two experts in Tunisia). In most cases there are no safeguards against politically motivated dismissals, except in Egypt. Moreover, there are few restrictions on what board members can do during or after their term ends. Only in Algeria and Kuwait are board members prohibited from holding other private or public positions, while Egypt is the only country that bars board members from working for companies that were under investigation during their tenure. The cooling-off period in Egypt is two years. Any failure to restrict post-service employment likely reduces *de facto* independence.

Moreover, in Morocco, the government can review merger applications from a “general interest” angle in parallel with the review performed by the Council on the competition impact of proposed mergers. Government reviews can overturn Council decisions. In addition, a subtler form of influence can be exercised through funding decisions. The executive branch oversees spending, except in Morocco, where Parliament approves the budget. There are no mandatory contributions by firms in any country, so all competition authorities in this sample of seven are fully dependent on public funds.

Competition agencies must not only be independent, they must be accountable—that is subject to legal and institutional mechanisms that ensure they use their power fairly and proportionally. Competition policy is an intrusive tool that can interfere significantly with the exercise of property rights and possibly lead to the imposition of hefty fines, or even imprisonment. Safeguards are needed. Some apply to the exercise of power in individual proceedings; while others speak to the agency’s broader responsibility to explain its actions to key stakeholders and to the population at large. In this way, the eternal dilemma of “who will guard the guardians” can find a reasonable, if imperfect, solution³³.

In exercising its power, the competition agency must grant rights of defense to the parties under investigation. Therefore, the rules of the proceedings must be fair and ensure that the defendants have access to the entire case file, are able to provide exonerating evidence, and can be heard by the adjudicating body before it takes its decision, which must be justified and based on sound economic and legal assessments of the facts. Moreover, fairness implies uniform and nondiscriminatory decisions in cases that feature similar issues.

In the MENA region, procedural safeguards are sometimes incomplete. For example, in Jordan there are no clear provisions concerning oral hearings and access to the entire case files. Similar issues seem to exist in Oman. Nevertheless, the right of appeal is present in all countries. This means that the final outcome will rest on the quality of the judiciary.

At a broader level, the design of the investigation/decision process also plays a major role in controlling confirmation bias—the tendency to give unwarranted weight to evidence that seems to prove the infringement and to dismiss exonerating documents. One way to approach this is to separate the investigative and adjudicative functions into

³³ See Hurwicz (2008).

two bodies—say the competition authority and the courts. The other is to have a functional separation within the competition authority between investigation and sanctions—while ensuring that any decision can be appealed, which gives defendants the right to an effective judicial review.

In MENA there are a variety of approaches. Egypt, Jordan and Oman follow the separation model—although in Egypt and Kuwait only for imposition of fines, not for issuance of cease- and-desist orders. All the other countries keep investigation and decision-making within the agency; only Morocco and Tunisia have a functional separation between investigation and decision.

When it comes to its broader accountability responsibilities, the competition authority must be open and constantly seek opportunities to explain its activities to key stakeholders (government, parliament, and business and consumer associations) and the wider population. The most important accountability action is to make available in a timely manner (ideally on the institutional website) details of decisions on individual cases, which should make clear how the competition authority interprets its mandate, applies the law and uses economic tools in practice—which enables outside assessments of the quality of enforcement.

The agencies should also post an annual report that contains a reasoned review of the enforcement and advocacy activities. It could also explain the authority’s strategic vision and its action priorities for the coming year. The report could also occasion an opportunity to nurture a dialog with the government and parliament, which is fundamental to ensuring that advocacy actions are taken seriously, and the competition authority does not become an unheard voice³⁴.

Moreover, the budgets must also be made public, as should board members’ and top management’s outside interests (employment, membership in associations, investments and the like) to help prevent conflicts of interest.

In the MENA countries considered, openness is limited³⁵. Although the publication of decisions and of an annual report is required in all countries, the information is often not made readily available (such as on institutional websites) and when it is, details are so sketchy that the analysis and the motivation underpinning the intervention are unclear. With respect to broader engagement with stakeholders, only Egypt, Jordan, and Morocco have published policy guidelines on topics of interest for antitrust enforcement.

Accountability and transparency also help enforcement. They contribute to clarity and predictability about how the agency sees market developments—which facilitates compliance by the firms that play by the rules—and deter bad behavior because companies want to avoid the reputational costs of being found guilty of an anticompetitive practice. Finally, transparency and accountability strengthen the integrity of the competition authority, contributing to the overall legitimacy, trustworthiness and general acceptance of the competition framework.

³⁴ See Jenny (2012).

³⁵ See Mahmood and Ait Ali Slimane (2018), p. 95.

› MENA governments must take action

Fair competition and contestability are powerful forces for ensuring allocative, productive and dynamic efficiency and at the same time can be strong antidotes to inequality by creating economic opportunities and making goods more affordable. These are key goals for the MENA region, which is plagued by dual economies where a stagnant official sector coexists with widespread informality and unemployment that deprives citizens, especially younger ones, of hope.

Because well-functioning markets cannot be taken for granted, good antitrust legislation and enforcement is needed to preserve and nurture them. Unfortunately, in the MENA region the quality of the existing competition frameworks is largely below what would be obtained by following best practice. This places a big burden on their economies, while substantially benefiting the political and economic oligarchies.

Countries without an antitrust law should consider speedily enacting one, while the others should improve antitrust enforcement by eliminating the many exceptions to its application and by granting authorities all the necessary powers. Both their independence and the accompanying accountability instruments should be significantly strengthened.

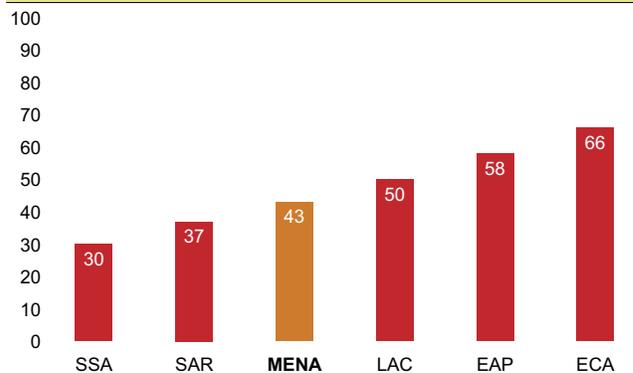
1B. Competition and Rule of Law Go Hand-in-Hand³⁶

If economies in the Middle East and North Africa are to deliver opportunities and high-quality services to a growing and increasingly educated population, they must undergo major changes. Among other things, these economies must reduce high levels of market concentration, strengthen the rule of law and end pervasive cronyism.³⁷ Weaknesses in these three areas constitute almost impenetrable barriers to firms entering or leaving crucial markets.³⁸

This lack of contestability means that MENA economies have favored incumbent firms—whether private sector or state-owned enterprises—which has led to rent-seeking. Because incumbent firms are so politically connected, cronyism will be difficult to eradicate.³⁹

Increased contestability and improved development outcomes for MENA countries require credible institutions that permit newcomers to challenge the status quo and establish a more level playing field.⁴⁰ Well-performing competition authorities are a necessary part of such an institutional landscape. But if competition authorities are to make a dent in

Figure II.2. Rule of Law in MENA in Comparison with Other Regions in 2017



Source: Worldwide Governance Indicators.

36 This section was authored by Klaus Decker. The author thanks Nadine Cherfan, Gamila Kassem, Marouan Maalouf, Saba Gheshan, and Zoubida Al Tayib for their contributions and Renaud Seligmann, Adam Shayne, Adele Barzelay, David Bernstein, Tania Begazo Gomez, Dahlia Khalifa, Graciela Miralles Murciego and Jean Denis Pesme for their comments.

37 See Speelman (2016), pp. 1229 and 1231.

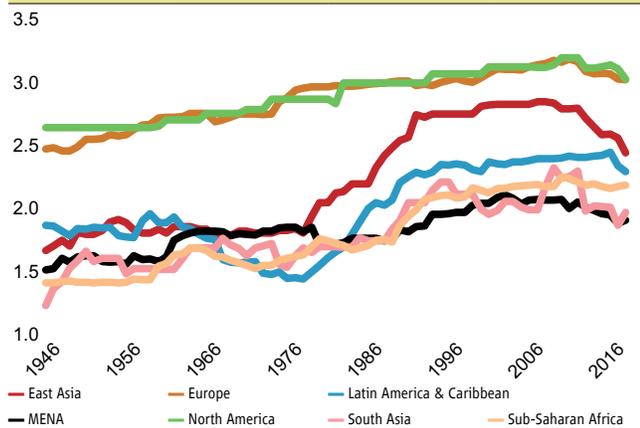
38 Arezki (2019).

39 World Bank (2009); Diwan and others (2015) and Rijkers and others (2017).

40 See World Bank (2017); see also Mahmood and Ait Ali Slimane (2018) p.9.

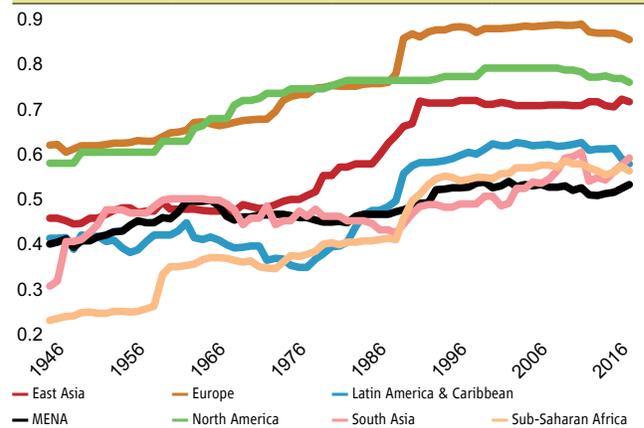
anticompetitive practices, an independent judiciary is needed to uphold the rules of the game.⁴¹ Otherwise legal certainty and predictability are undermined. In countries with effective justice institutions, stakeholders anticipate predictable and rule-based court outcomes and carry out their business “in the shadow of the law.” If they do not, they risk suffering the legal consequences. In reality, because of lack of legal certainty, weak property rights and underperforming justice institutions in many MENA countries, the region performs poorly compared with other regions on a measure of the rule of law⁴² (see Figure II.2). Challenges include inadequate access to justice and lack of transparent laws with predictable enforcement (see Figures II.3 and II.4).

Figure II.3. Access to Justice in MENA vs Other Regions, 1946–2017



Source: Varieties of Democracy, 2019.⁴³

Figure II.4. Transparent Laws with Predictable Enforcement in MENA vs Other Regions, 1946–2017



Source: Varieties of Democracy, 2019.

In MENA, progress in access to justice over the past 50 years has been moderate—from a relatively low starting point. Regions once outperformed by MENA have so improved their performance that MENA has the lowest level of access to justice of any region in the world (Figure II.3). It is also the region with the lowest scores internationally for transparent laws with predictable enforcement.

Two issues stand out in the relationship between contestability, justice sector institutions, and rule of law in MENA: First, how do the mandates of competition authorities and justice sector institutions complement each other? Second, how does the court system affect the ability of newcomers to challenge incumbents and how does it enforce any legal and regulatory framework?

► Complementarity of the competition authority and the courts.

The effectiveness of competition authorities and justice sector institutions in ensuring that the legal and regulatory framework promotes competition and contestability depends on a number of factors. Laws and institutions play a role.

41 Khemani (2007), p. 29; see also United Nations (2015), p.7.

42 The “rule of law” under the Worldwide Governance Indicators captures “perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.” For more details see Kaufmann et al (2010)

43 Varieties of Democracy, for more information see <https://www.v-dem.net/en/>

Justice institutions in particular are crucial specifically for deciding competition cases and more broadly for their appeals role and for ruling on issues other than competition that can affect contestability.

The legal and institutional framework for competition in MENA is based on laws and institutions

Laws: Five MENA economies have no competition law—Bahrain, Iran, Lebanon, Libya, and West Bank and Gaza⁴⁴—while Djibouti and Iraq have a law but no enforcement authority.⁴⁵ To varying degrees the competition laws and institutions are modeled after systems in the United States and European Union.⁴⁶ The result is a heterogeneous pattern of competition laws across MENA that, unlike those laws in OECD countries, are less organically integrated in the legal and institutional system in MENA countries.⁴⁷ One reason for this is that individual countries respond to pressures from different international sources that make trade or aid dependent on the adoption of competition legislation.⁴⁸ Another is that a culture of contestability that could make the transplanted legal and institutional systems fully operational has not generally taken deep root in MENA.⁴⁹

Competition laws in MENA may seem consistent with typical substantive EU or U.S. antitrust provisions,⁵⁰ but unlike both of them, MENA allows large exceptions to and exemptions from competition law that present major limitations on contestability (see Box II.5 for a summary and section 1C for details).

Box II.5. Undermining contestability in MENA

Exceptions reduce the scope of competition law. For instance, Egypt, Morocco, Tunisia, and Jordan have broad exceptions regarding essential goods and services whether originating in the public or private sectors.⁵¹ Moreover, exemptions apply to legal monopolies. Competition laws in Kuwait, Saudi Arabia, and the United Arab Emirates exempt activities and transactions initiated by state-owned enterprises and define broad sector-based exemptions.⁵² Exempting large sectors of the market economy from competition law sabotages the fundamental principles of contestability.

Institutions: Where competition authorities exist in MENA, their institutional design and powers are based either on a *bifurcated judicial model*,⁵³ inspired by the United States, or on an *integrated agency model*, adopted in the EU, or a combination of the two (see Box II.6). Under the bifurcated judicial model, the competition authority has investigative powers and must bring enforcement actions before the general courts.⁵⁴ Under the integrated agency model, a single body is entrusted with the investigative, enforcement and adjudicative functions.⁵⁵ Courts here serve an appeal function.

44 Youssef and Zaki (2019), p. 4. For an overview see id. p. 48.

45 Idem, p. 5.

46 Speelman (2016), pp. 1228-9.

47 Idem, p.65.

48 Idem, p. 51.

49 Arezki (2019).

50 Mahmood and Ait Ali Slimane (2018) p. 84

51 United Nations (2015), p.31.

52 Fitch & Co (2018); see also United Nations (2015), p. 30.

53 Mahmood and Ait Ali Slimane (2018), Box 2.5.

54 Idem.

55 Idem.

Moreover, although on average competition authorities begin operating within four years after the passage of a competition law, it often takes longer. In Algeria, for example, there was an 18-year delay.⁵⁶ In the case of Morocco, the Competition Council was set up in 2008 with a limited, mainly advisory role. The 2014 law amendment has broadened and strengthened its powers conferring on it broad decision-making, sanctioning, coercive fining and self-referral powers. The Council became fully operational in November 2018.⁵⁷

Box II.6. Competition authorities in MENA

The makeup of competition authorities in MENA countries depends on how much a country borrowed features from the U.S. or EU system. Tunisia and Morocco adopted an integrated agency model,⁵⁸ while Egypt, Jordan and Oman roughly follow the bifurcated model. Egypt's competition authority brings enforcement actions to the courts, while Jordan and Oman refer cases to a public prosecutor.⁵⁹ In Jordan, Qatar, the UAE and Yemen competition authorities are part of a ministry.⁶⁰ But there are local variations of the powers and enforcement reach of competition authorities.⁶¹ Most MENA countries give their competition authorities powers to enforce the regulatory framework against anticompetitive practices.⁶² But some, such as Egypt and Jordan, have opted for a judicial enforcement system, while Tunisia and Morocco have administrative enforcement.⁶³ For neither group are the judicial mechanisms uniform.⁶⁴

While the reality of MENA's competition authorities is more nuanced than the dichotomy between the integrated and bifurcated models suggests, the distinction remains useful when it comes to the role of justice sector institutions.

The role justice institutions play in competition cases depends on whether countries combine enforcement and adjudication in one body or split them between the executive and judicial branches. In general, justice sector institutions are separate from competition authorities under the bifurcated model. In the integrated agency model, the competition authority is a hybrid of an executive agency and a specialized court, which blurs or eliminates the distinction between competition authorities and justice sector institutions. A certain level of independence from day-to-day management of a minister or the political bodies of government is important for the effective functioning of any competition authority.⁶⁵ In the integrated agency model issues such as judicial and prosecutorial independence become part and parcel of the independence analysis of competition authorities. Under this model, the concentration of powers represents a key governance vulnerability if there are not adequate checks and balances to guarantee due process and prevent lack of impartiality in adjudication.⁶⁶

Under the bifurcated model, the investigation is assigned to the competition authority, which would then bring the case to court. Without both a well-functioning competition authority and a well-functioning court system with adequate capacity and independence, contestability would be unachievable. If any of the required institutions is underperforming

56 Mahmood and Ait Ali Slimane (2018), p.83.

57 Youssef and Zaki (2019) p. 5.

58 Speelman (2016) p.1235.

59 Mahmood and Ait Ali Slimane (2018), p. 87.

60 Youssef and Zaki (2019).

61 Speelman (2016) pp 1230-31.

62 Mahmood and Ait Ali Slimane (2018), p. 87.

63 Speelman (2016) p. 1251.

64 E.g. the judicial systems in Jordan and Egypt vary significantly. *Id.*

65 Mahmood and Ait Ali Slimane (2018), p. 89.

66 *Idem*, p. 92.

or captured, the entire system will not perform properly. Egypt’s first case exemplified how all institutions performed well (see Box II.7).

Box II.7. Egypt’s 2008 landmark competition case

The first competition case before the Egyptian courts in 2008 was against nine major cement companies. The Egyptian Competition Authority (ECA) referred its report to the Ministry of Trade and Industry to file a criminal lawsuit. Until 2014 ECA lacked the authority to bring a case to court directly. The objective in 2008 was to dismantle a cartel that fixed prices and market allocation. The first instance court upheld the ECA finding and imposed the maximum fine on the companies and their executives for violating laws on price fixing and limiting the process of marketing of goods.⁶⁷ The defendants appealed solely on procedural grounds but the decision was upheld.⁶⁸

Excessive cost of court proceedings, long delays at the prosecution, trial and enforcement stages and weak quality of court decisions are important ways in which judicial systems underperform and present key impediments that must be addressed to ensure contestability. Some see this as a weakness of the bifurcated model.⁶⁹ However, the same judicial and prosecutorial weaknesses affect the integrated agency model, except that challenges must be addressed primarily within the agency itself to ensure contestability. While still daunting, this task may appear more manageable and worthwhile given other advantages of this model.⁷⁰

The concentration of powers in one agency helps ensure a strong regulatory authority equipped with an arsenal of tools that includes those normally reserved for the courts. The civil, criminal and administrative court system plays a more limited role, operating more or less as an appeals mechanism to the adjudication and enforcement power of the competition authority. However, this concentration of powers makes the integrated agency model more vulnerable to elite capture, which would undermine contestability. Under the bifurcated approach, more institutions would have to be captured to limit contestability. As a consequence, appropriate design in terms of independence, appointment, security of tenure, and other institutional protection features are of particular importance. But international good practice in this respect is not always followed in MENA.⁷¹

Under either a bifurcated or integrated approach, the general court system remains essential to increasing contestability. Competition authorities are the logical first contact for newcomers challenging competition law infringements by incumbents. Successful contestability depends on the general courts under the bifurcated judicial model and on the competition authority as a specialized first instance court under the integrated agency model. However, the general court system is crucial to increasing contestability under either model (see Box II.8).

The general court system normally provides a venue to appeal decisions and outcomes of the first instance court. This ensures adequate due process. Such procedural safeguards are prerequisites for an effective competition policy. The appeals courts and the apex courts (such as the U.S. Supreme Court) also ensure uniform application of the law. They check the accurate and constant application of competition law—ensuring predictability and legal certainty. If appeal courts

67 See Elfar (2009).

68 Speelman (2016), p. 1248.

69 Mahmood and Ait Ali Slimane (2018), p. 91.

70 Idem, p. 92.

71 Idem, p. 89 for independence, p. 90 for appointment process, p. 93 for board composition, and p. 95 for procedural fairness and transparency.

are captured by elites and fail to perform their functions properly, they become an obstacle to contestability because they have the adjudicatory power to undermine decisions taken at the competition authority and first instance levels. Therefore, successful implementation of either model of competition law relies on the broadly effective performance of the court system.

Box II.8. First instance jurisdictions and appeals

Different parts of the judicial system tend to be involved in competition cases, in first instance as well as in appeals. There is no general principle across MENA that appeals remain within the civil courts or systematically go to the administrative courts. In Tunisia, decisions rendered by the competition authority following the integrated agency model are subject to an appeal before the administrative court. Under Jordan's bifurcated system, civil courts have the jurisdiction to adjudicate cases based on the Competition Law and Unfair Competition Law. Cases relating to economic monopoly and competition go to a specialized civil court named "Economic Chamber." All cases can be appealed up to Jordan's Court of Cassation. Appeals against executive decisions made by the Ministry of Trade and Industry under the Competition Law, however, can be appealed to the administrative court. The administrative court has the authority to revoke executive decisions and has done so.

The mandate of the courts extends beyond narrow competition issues. There are also venues for contestability that the general civil, criminal and administrative court system may offer beyond what is within the jurisdiction of competition authorities. For example, unless general tortious liability (that is, for harmful actions) is excluded by competition law,⁷² challenging anti-competitive behavior before the regular courts would normally be possible for claimants who can prove the three conditions of tortious liability: fault, damage and causal link.⁷³

Contestability also depends on the ability of newcomers to hold public authorities and civil servants accountable for anti-competitive behavior. The administrative courts could provide venues for challenging behavior by public authorities that favor incumbents. This may include permits and licenses issued for incumbents or refusals to issue them for newcomers under the same conditions. Such administrative acts could be challenged by newcomers. If the behavior is based on corruption (such as a bribe) or other criminal behavior, the general criminal courts have an important role to play to diversify the arsenal of newcomers looking for ways to challenge incumbents and their allies.

Public procurement is outside competition law but an area in which courts can play a role in enabling newcomers to challenge actions by public authorities that favor incumbents. Public purchasing is an essential source of business. It accounts for one-fifth of the global GDP and represents about half of public spending in middle-income countries.⁷⁴ Access to justice mechanisms is an important way to shield public procurement from privileges and corruption. It fosters contestability by ensuring fair competition among bidding firms and then allowing a procurement award to be contested, first administratively, then judicially. Shortcomings in access to justice ultimately undermine the benefits of regulations that favor transparency and fair treatment when firms cannot obtain redress against irregularities.⁷⁵ Courts are also crucial to enforcing laws in key sectors of the economy—such as electricity, telecommunications and transportation—

⁷² Such a prohibition exists in Tunisia, for example: companies cannot proceed to any other courts, if the matter concerns anti-competitive practices.

⁷³ This is similar to compensation by courts for unfair trade breaches. From a regulatory point of view, it does not constitute a cohesive policy for regulating competition.

⁷⁴ Mahmood and Ait Ali Slimane (2018), p. 45.

⁷⁵ *Idem*, p. 48.

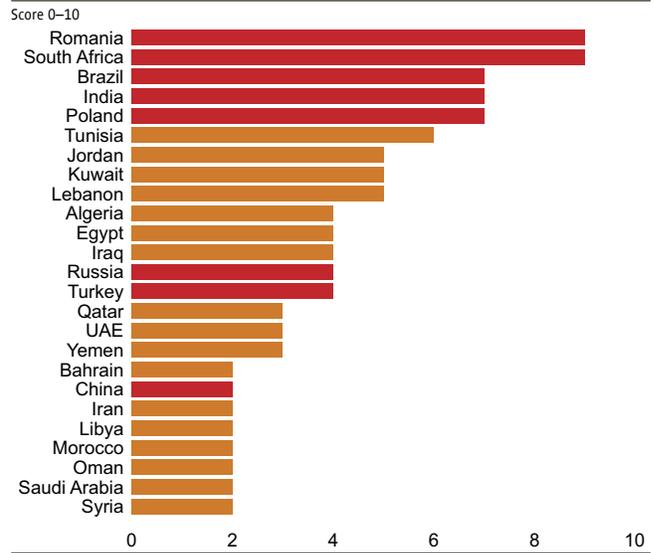
especially when legal and regulatory frameworks affect access of newcomers to essential infrastructure under non-discriminatory conditions.

Low levels of contestability across MENA mean that newcomers are in a weak position compared to incumbents, especially those that are well connected politically. In such environments, newcomers need courts to be independent arbiters and to perform well to ensure a somewhat level playing field and to challenge the status quo, assuming the required legal and regulatory framework exists. Underperforming courts become part of the protective veil over incumbents and cronyism and increase the probability that challenges to the status quo will not succeed. As noted above, compared to other regions, MENA performs poorly on both rule of law and access to justice. Accessible and impartial dispute resolution is generally considered a key element of the rule of law, requiring justice to be delivered timely by competent, ethical, and independent representatives and neutrals who are accessible, have adequate resources, and reflect the makeup of the communities they serve. Judicial independence in MENA countries generally lags the rest of the world too (see Figure II.5).

MENA also scores poorly relative to other regions in terms of government effectiveness,⁷⁷ (see Figure II.6), which includes the justice sector.

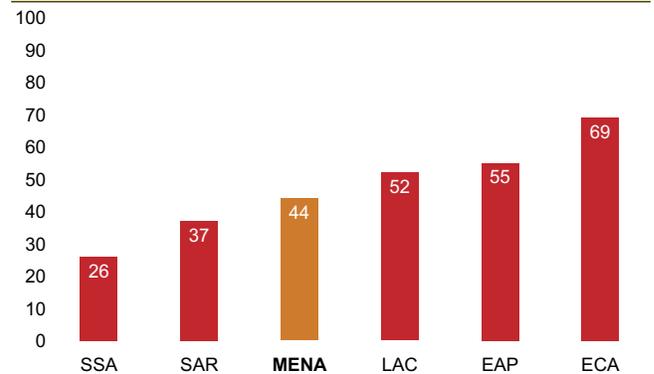
When it comes to courts in particular, many judicial systems in MENA perform poorly in terms of the quality of processes in place to deliver services to court users. That is why many MENA countries have low scores under the Quality of Judicial Processes Index of the World Bank’s Doing Business report,⁷⁸ (see Figure II.7). With the exception of the UAE and Malta, no MENA country scores even half of the available points.

Figure II.5. Judicial independence in selected MENA countries vs selected comparator countries, 2018



Source: Bertelsmann Transformation Index.⁷⁶

Figure II.6. Government effectiveness in MENA compared to other regions in 2017

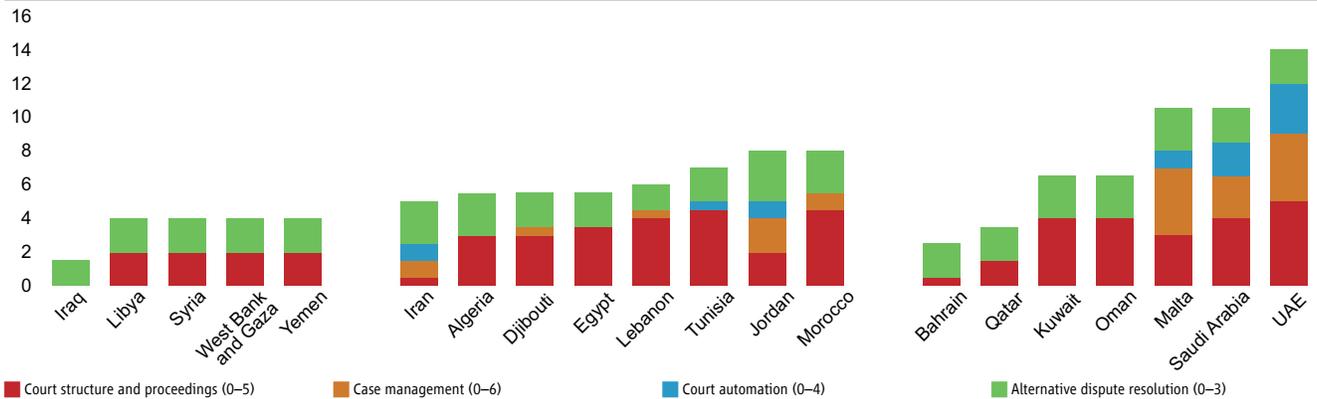


Source: Worldwide Governance Indicators.

⁷⁶ The Bertelsmann Transformation Index defines judicial independence as the ability and autonomy of a judicial system to interpret and review existing laws, legislation and policies, both public and civil; pursue its own reasoning, free from the influence of political decision-makers or powerful groups and individuals and from corruption; and develop a differentiated organization, including legal education, jurisprudence, regulated appointment of the judiciary, rational proceedings, professionalism, channels of appeal and court administration.

⁷⁷ According to the Worldwide Governance Indicators, the data on Government effectiveness capture “perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government’s commitment to such policies.” (Kaufmann et al, 2010).

⁷⁸ The Quality of Judicial Process Index is a composite index measuring the extent to which courts have specific processes in place that are considered international good practice. For more detailed information see www.doingbusiness.org.

Figure II.7. Quality of Judicial Processes Index scores for selected MENA Countries⁷⁹

Source: *Doing Business in 2019, Enforcing Contracts*.

The absence of good practice elements in much of MENA results in underperformance of the courts in terms of service delivery, which further undermines contestability. In economies affected by fragility and conflict—such as Libya, Syria, the West Bank and Gaza, and Yemen—the situation is particularly difficult of course. But non-fragile middle-income and even high-income countries in MENA also continue to struggle.⁸⁰ Typical areas of underperformance are in efficiency of service delivery, quality of services delivered, and accessibility of services.

When it comes to efficiency of service delivery, many judicial systems in MENA suffer from delays at various stages of the procedure (including investigation, hearings, adjudication, and enforcement). While such delays are generally blamed on dysfunctional legal frameworks and capacity constraints, the World Bank has found that they are not the cause but rather are symptoms of a broader political economy challenge and that the underlying causes are related to the nature of existing elite bargains.⁸¹ These inefficiencies also undermine contestability because delays tend to benefit the stronger parties, which are the incumbents.

Similarly, the quality of legal certainty and predictability at the investigation, adjudication and enforcement stages often remain weak due to inconsistencies in the application of the law. While this deficiency in service delivery is a general challenge in many judicial systems in MENA, it is more critical in competition cases because they are technical and require an understanding of economic concepts that few judges possess.⁸² The service deficiency tends to aid those with deeper pockets and better connections with the elite, because as incumbents they fundamentally do not need the courts to perform well and can rely on the status quo to work for them.

⁷⁹ The graph shows the results in three groups based on GDP per capita, from low to high: fragile and conflict-affected countries, middle income countries not directly affected by fragility and conflict, and high-income countries. Within each group the order by score, from low to high.

⁸⁰ Speelman (2016), p. 1252.

⁸¹ See World Bank (2017).

⁸² See for examples Khemani (2007), p. 34-35.

1C. MENA Countries Vary Their Approach to Ensuring Competition⁸³

Although almost all countries in MENA have laws and institutions aimed at ensuring competition in their economies, they take different—and more or less effective—approaches. The following section presents profiles of five MENA countries and their competition and regulatory frameworks.

EGYPT

The 2005 Competition Law in Egypt created key elements to foster competitive markets, including the Egyptian Competition Authority (ECA).⁸⁴ The law covers both private and public operators, prohibits anticompetitive agreements, concerted practices, and abuses of dominant or monopolistic positions. The law was amended in 2008⁸⁵ and revised in 2014,⁸⁶ as part of a constitutional reform that stressed the role of competition policy for the Egyptian economy.⁸⁷ The 2014 amendments not only reinforced ECA's independence and advocacy powers but also strengthened its enforcement tools through higher fines, enhanced settlement powers and a leniency program. As a result, ECA's decisions against anticompetitive practices increased significantly—covering a wide range of markets, including anticompetitive agreements in insurance, pharmaceuticals, fertilizers and poultry and abuses of dominance in telecommunications, electricity, media, and sports.

However, key concerns remain, especially about limitations on ECA's mandate:

- ECA's governance structure may affect its independence, especially due to ministerial representation in ECA's Board⁸⁸.
- Inability to issue fines for anticompetitive behavior can weaken its decisions. The ECA can document violations, issue cease and desist orders against anticompetitive practices and even reach extra-judicial settlements with wrongdoers. But only economic courts may impose fines for antitrust violations.
- Exclusions and exemptions from the competition law (Article 9) may affect competitive neutrality and discourage entry. Most countries allow no such exemptions (see Figure II.8).
- Lack of power over mergers makes it difficult to control the anticompetitive effects of market consolidation.

Efforts to enhance ECA's mandate are under Parliament review. Proposed amendments to the law would create an impartial Board—composed of ECA's chair and two senior technical staff, judges and academics—that would report to the President rather than the Prime Minister. ECA would have more budgetary autonomy and would gain the power now held by the judiciary to sanction anticompetitive practices and increase transparency through enhanced publishing obligations.

⁸³ This section was prepared by Graciela Miralles Murciego with co-authors Mahmoud Momtaz and Georgiana Pop. Guidance was provided by Tania Begazo Gomez.

⁸⁴ Law No. 3 of 2005 on the Protection of Competition and the Prohibition of Monopolistic Practices.

⁸⁵ Law No. 190 of 2008.

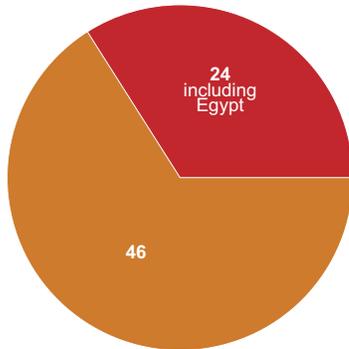
⁸⁶ Presidential Decree Law 56/2014, Official Gazette, Volume 26 bis (e), 2 July 2014.

⁸⁷ Constitution of the Arab Republic of Egypt, January 18, 2014, available at: https://www.constituteproject.org/constitution/Egypt_2014.pdf

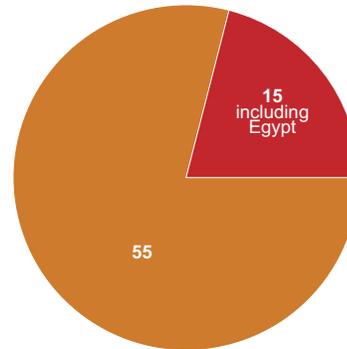
⁸⁸ ECA's decision-making Board has 10 members: from the General Federation of the Chambers of Commerce, the Egyptian Federation of Industries, the General Federation for Consumer Protection, the administrative court (State Council), independent experts and several ministries (Article 12 of the Competition Law).

Figure II.8. Exclusion or exemption from competition law

Panel A. Share of countries that exclude or exempt from competition law conduct that is required or authorized by another government authority



Panel B. Share of countries where publicly controlled firms are subject to some form of exclusion or exemption from the general competition law



■ Yes ■ No

■ Yes ■ No

Source: Markets and Competition OECD-WBG PMR. Questionnaire for Arab Republic of Egypt, OECD PMR database and OECD-World Bank Group PMR database for non-OECD countries.

Strengthening efforts to promote regulations that support competition is a necessary complement to ECA's enforcement strategy. Addressing government regulations and practices that restrict market competition or weaken the enforcement of competition policies are as important to making markets work as are detecting and prosecuting anticompetitive violations. Thus, coordinating policy efforts to generate a competitive business environment and promote contestable and open markets is vital to creating incentives for entrepreneurship and increasing pressures to innovate.

The contribution of the Egyptian Competition Authority in formulating pro-competition regulations can be substantial, particularly on matters such as regulated sectors, state involvement in commercial activities and price controls. To achieve an effective competition policy, collaboration between the Competition Authority, sector regulators and other policy makers is necessary. For instance, the inclusion of an ECA representative in the Board of the Egyptian Electric Utility and Consumer Protection Regulatory Agency (EgyptERA) has allowed ECA to take an active role in the efforts of the Egyptian government to embed competition in the electricity sector. This type of cooperation is a practical example of how connecting competition policy and other public policies can elevate competition in Egypt's economic agenda.

(Source: World Bank Group Market and Competition Policy team)

JORDAN

In 2002, Jordan was among the first countries in the Middle East and North Africa (MENA) to pass a competition law, which established a Competition Directorate within the Ministry of Industry and Trade and Supply (MoITS). In 2004, Jordan enacted the current law, which aimed at further enhancing competition in Jordanian markets.

The 2004 law prohibits anticompetitive agreements and abuse of dominance. It gives the competition directorate the power to control mergers, to curb negative effects of market consolidation. Nevertheless, a number of concerns remain about the effectiveness of the Jordanian government's anticompetition situation, including:

- Limited independence for the competition enforcer
- Exclusion of pricing regulation from the purview of the competition law
- Weak treatment cartels
- Broad powers for the ministry, including deciding whether to refer cases for judicial prosecution and whether to exempt anticompetitive arrangements
- An unclear procedural framework and analysis criteria for merger review.

Unsurprisingly, only about 15 cases of anticompetitive behavior have been prosecuted since 2004; most investigations by the Competition Directorate have been resolved at the Ministry level without formal written proceedings, sanctions, or public notice. This approach severely hinders the deterrence effect of the law and reduces incentives for compliance.

The country's trade law also gives MoITS large powers to control prices. The government establishes monthly ceiling prices for 14 major staple goods (such as cereals, bread, sugar, olive oil, and milk) and intermediate goods (cement, steel reinforcing bars, and petroleum)—which may facilitate collusion. Moreover, firms cannot offer discounts without a license. Such limitations prevent price discovery and hinder efficiency-driven market dynamics.

The Competition Directorate's limited resources—it has about 10 technical employees and a small budget—also means it cannot produce many market studies to advocate for pro-competition reforms. An ongoing analysis by the World Bank Group to foster private sector development in Jordan identifies a number of government rules in key sectors such as tourism and transport that may constrain healthy competition. For example, there are high government-imposed barriers to entry for tourist bus operators—large minimum capital requirements, rules on the minimum number and type of vehicles they must have, and limitations on business activities and bank guarantees. Similar rules affect the transportation sector. The government sets minimum prices for transport services for containers and general cargo and requires a minimum number of owned/ leased trucks as requirement for obtaining a license as a transport company

Jordan 2025, the government's economic and social development plan launched in 2015, aims at strengthening the government's role in tackling anticompetitive practices that affect consumers and limit the ability of firms to grow and compete on a level playing field. However, challenges remain, notably due to limited enforcement and limited consideration for competition principles in sector-specific regulation.

(Sources: Jordanian temporary Competition Act No. 49, 2002; Jordanian Competition Act No. 33, 2004; World Bank Group Market and Competition Policy team; Jordan 2025. A National Vision and Strategy, 2015, available at <http://inform.gov.jo/en-us/by-date/report-details/articleid/247/jordan-2025>; WBG (mimeo), "Towards a more effective competition policy framework for Jordanian markets; Inputs from the Markets and Competition Policy team to the Jordan CPSD; Jordan Economic Growth Plan 2018 - 2022 The Economic Policy Council, 2017, available at <http://jordanembassyus.org/sites/default/files/Jordan%20Economic%20Growth%20Plan%202018-2022.pdf>)

KUWAIT

The idea of promoting competition was embedded in the Kuwaiti regulatory framework well before the Competition Law was enacted in 2007. The Kuwait Constitution of 1961⁸⁹ specifically prohibits monopolies unless “granted by a law,” and “for a limited period of time.” The constitution also includes “economic development and increased productivity” as goals of the national economy. Competition is a crucial input for such outcomes. Moreover, Kuwait assumed as law the competition obligations embodied in international agreements it signed. For example, Kuwait joined the General Agreement on Tariffs and Trade in 1963 and the World Trade Organization in 1995.⁹⁰

Approval of the Competition Law in 2007 represented an important commitment of the government of Kuwait to the competition agenda at a time when the only Gulf Cooperation Council countries with competition laws were Saudi Arabia (enacted in 2004) and Qatar (2006). The Kuwaiti law established the enforcement body, the Competition Directorate, within the Ministry of Commerce. The law was amended to establish a more independent agency under the supervision of a board. But it was not until 2012 that the directors of the Competition Protection Agency (CPA) were finally appointed. Even then, there were significant concerns about implementation. The law excluded from enforcement a large part of the Kuwait economy— including state-owned enterprises and potentially all regulated sectors. Moreover, CPA’s inability to hire technical staff meant it did not open for business until 2017.

In addition, the 2007 law had flaws that made it difficult to prevent anticompetitive behavior. It limited independence of the CPA from the ministry (requiring ministerial approval of decisions); did not distinguish between cartels and abuse of dominance; invested power to impose fines in the courts rather than in CPA (following the Egyptian model); and capped sanctions at certain amounts rather than basing them upon a firm’s revenue.

Nonetheless, the CPA has had successes. It has stopped anticompetitive practices in key sectors including digital platforms and steel through cease-and-desist orders and has referred cases to the public prosecutor.

In the past few years, the CPA also has:

- Submitted to Parliament a draft law, now under review, that would increase its independence, enhance legal certainty, and strengthen its investigative powers.
- Approved a five-year strategy to flesh out its role within the competition ecosystem.

The CPA has also embraced its advocacy role. It has issued advocacy opinions and built product market regulation (PMR) indicators for Kuwait in collaboration with the World Bank Group and the OECD. These indicators assess the extent to which rules and regulations are conducive to competition and provide critical information the CPA can rely when advocating for pro-competition reforms.

PMR data confirms that regulation inhibits competition in key Kuwaiti sectors:

⁸⁹ The Constitution of Kuwait was signed on 11 November 1961. Available in English at http://www.pm.gov.kw/en/state_of_kuwait/kuwaitConstitution.jsp

⁹⁰ For the general participation of Kuwait at the WTO see http://www.wto.org/english/thewto_e/countries_e/kuwait_e.htm

- Excessive state control appears to be the main source of concern. The government still controls or directly operates key economic sectors, and SOEs enjoy advantages that may hinder competitive neutrality. In addition, pervasive price regulation further distorts market outcomes.
- Incumbents seem to enjoy regulatory protection that limit the ability of firms to enter the market and to challenge incumbent dominance. Electricity, fixed line infrastructure/services in telecommunications, gas, and basic postal services are all legal monopolies, meaning that entry is prohibited by law. Moreover, SOEs that often hold a dominant or even monopolistic position in key sectors, are exempted from the competition law.
- Barriers to trade and investment also inhibit foreign participation in the Kuwaiti economy. Foreigners are permitted to own 100 percent of a company only if the business fulfills certain requirements and gets approval from the Kuwait Direct Investment Promotion Authority. Moreover, foreign suppliers are treated less favorably on taxes and eligibility for subsidies. These provisions limit the extent to which foreign companies can exert competitive pressure on local firms.

The government is making efforts to curb state participation in the economy, promote private sector development and reduce barriers to trade and investment. Key initiatives include both generic and specific privatization laws and public-private participation projects in real estate development, education, water and wastewater management, tourism, transportation, and solid waste management.

These efforts go in the right direction, but more needs to be done, especially in terms of competition enforcement and advocacy, if Kuwait is to unlock its full potential. Changes both in the competition law as well as in sector-specific regulation are critical to developing a more effective competition policy in Kuwait.

(Sources: Legal Review of the Kuwait Competition Law, World Bank Group, May 2014, Mimeo; Kuwait Competition Law number 10 for 2007 as amended by the Law number 2 for 2012; CPA annual report 2017-2018; AbdelSalam, I (January 2, 2019). Press interview with CPA Chairman, <https://www.aljarida.com/articles/1546351012212819000/> [accessed August 23, 2019]; CPA 2018-2023 Strategic Plan.)

SAUDI ARABIA

Saudi Arabia enacted its first Competition Law in 2004, setting up a Competition Council under the Ministry of Commerce and Investment.

The Council's mandate included the ability to punish anticompetitive practices (cartels and abuses of dominance), assess vertical restraints, and control the anticompetitive effects of mergers. But the original law also exempted all public entities and fully owned state-owned enterprises (SOEs), limited sanctioning power, capped fines, restricted its scope to firms operating in Saudi Arabia only, and gave broad powers to the Council of Ministers to set prices for any good or service.

Although a Decision Committee was empowered in 2014 to issue fines calculated on the basis of firms' turnover (a regulatory concept closely related to revenue), broader reforms were needed to foster a more effective competition policy framework in Saudi markets.

To that end, the launch of Saudi Arabia Vision 2030 three years ago—the kingdom’s economic and infrastructure plan with a strong focus on reducing barriers to firms entering and leaving the market —resulted in much needed institutional changes. In 2017, the Council of Ministers transformed the Competition Council into the General Authority for Competition (GAC) with financial and decision-making independence. This new setup allowed for an increase in the number and quality of technical staff as well as the number of cases handled by the authority. A new competition law in March 2019 further enhanced GAC powers and introduced significant changes in the scope of the law by, among other things:

- Limiting exempted SOEs to those exclusively authorized by the Government to provide a specific good or service
- Expanding GAC’s territorial powers by allowing it to sanction violations by firms operating outside Saudi Arabia with effects inside the kingdom
- Applying the competition law in all sectors of the economy
- Introducing key enforcement tools such as a leniency program and the ability to terminate cases through settlements.

GAC enforcement policy has become one of the most successful in the MENA region in terms of cases investigated and fines levied. GAC has handled a number of complex cases in the past few years, in industries such as pharmaceuticals, food and beverage, retail, telecommunication, and media/sports. The recent sanctioning of a bid rigging cartel in the supply of medical oxygen to the Ministry of Health is the most recent example.

However, the scope of exemptions and price controls still raises concerns. SOEs are present in key sectors such as telecom, petroleum, and petrochemicals where they typically hold prominent market positions—especially those companies exempted from the application of the law. This approach hinders competitive neutrality resulting in an unlevel playing field. The effective implementation of the new law approved early this year may change that and refocus GAC’s attention on advocating to spread competition principles to all Saudi markets.

(Sources: World Bank Group Markets and Competition Policy team elaboration; Competition Law issued by Royal decree (M/25) dated 04/05/1425H (Corresponding to 22/06/2004); Council of Ministers resolution No. (55) dated 20/1/1439h (Corresponding to 11/10/2017); New Competition Law issued by Royal decree (M/75) dated 29/06/1440H (Corresponding to 07/03/2019); AlOtaibi, M (2010). Does the Saudi Competition Law guarantee protection to Fair competition? UCLAN; CC annual report 2016; GAC annual report 2017.)

TUNISIA

Although Tunisia has made some moves toward economic liberalization, its competition policies do not fully enable private sector participation, which reduces economic opportunities for growth and job creation.

Private sector participation is restricted in several key markets due to the presence of legal monopolies or dominant players—in industries such as air and railroad transportation, port operations, water and electricity distribution, and some agricultural products.

Administrative control of market prices and margins are relatively extensive too, and include bread, milk, edible oils, flour, coffee, tea, fruits, and meat. Price controls discourage increased production and diversification into higher-value adding activities for some product lines.

Lack of competitive neutrality between state-owned enterprises (SOEs) and private companies translates into state support measures and subsidies, such as capital injections and guarantees for SOEs in financial difficulty, which are granted through an ad-hoc process instead of clearly defined criteria. State support often results in recurrent bailouts of loss-producing SOEs, which strains the state budget and distorts markets.

Preferential treatment of nationals—by restricting foreign investment and administrative requirements—further inhibits the development of open markets with few barriers to the entry (or exit) of firms.

In 1991 Tunisia became one of the first countries in the MENA region to pass a competition law. But the regulatory and institutional framework for its implementation remained problematic for many years:

- The competition rules relied too heavily on discretionary decision-making and contained several exceptions that limited their effectiveness.
- The institutional framework resulted in duplicated functions of the Competition Council and the Ministry of Commerce, gave the decision-making role for merger approval and fine negotiation to the Minister of Commerce and did not require publication of the Competition Council decisions.

The lack of competition retards Tunisian market development and productivity. The 2014 World Bank Group Development Policy Review for Tunisia found that a 5-percentage-point decrease in the price-cost margins—the improvement that should result from increased competition in a sector—could increase labor productivity by 5 percent, on average.⁹¹

The government moved to increase the effectiveness of competition policy in 2015 when it adopted a new Competition Law, after consulting with domestic and international stakeholders, including the World Bank and the European Union.

The 2015 law strengthened the mandate of the Competition Council; increased the transparency of the decision-making of the Competition Council and the Ministry of Commerce (although it still does not require publication of competition decisions); redefined the criteria to grant exemptions in line with EU best practice; allowed the Council to do targeted economic analysis to motivate investigations; added the power to grant leniency to whistleblowers in cartel cases; streamlined merger review processes; and increased the level of fines.

The country also approved secondary legislation to foster effective implementation of the new competition law. The secondary legislation includes procedures for obligatory consultations with the Competition Council in the drafting of new laws and decrees; procedures for exemption from the competition law of those agreements that are justified based on economic or technical progress; guidelines for increasing the threshold above which the government must be notified of mergers, and procedures for leniency applications for those cooperating with investigations, which increases legal certainty for potential applicants.

⁹¹ See, *Development Policy Review for Tunisia*, World Bank Group 2014 at pp. 62 and following.

However, enforcement of competition law alone is insufficient to ensure a level playing field. Removal of sector-level regulatory barriers to entry and promotion of firm entry and competition is needed. In addition, pro-competition policies must be fully integrated into the broader government agenda accompanied by effective implementation of the competitive neutrality principles across markets—including increasing transparency and oversight of state aid to minimize market distortions.

Because implementation of the competition law is still challenging, improvements to the antitrust framework will complement measures to reduce restrictive product market regulations and are expected to tackle any market distortions stemming from firm behavior.

(Source: Development Policy Review for Tunisia, (World Bank Group 2014) and Tunisia: Business Environment and Entrepreneurship Development Policy Loan Project (World Bank Group 2017))

CHAPTER 2. STATE-OWNED ENTERPRISES AND THE PRIVATE SECTOR

The chapter discusses several aspects of the functioning of state-owned enterprises (SOEs) and more generally of public economic policies that influence competition and market contestability. First, it is crucial that SOEs do not receive undue advantages with respect to private firms in the markets where they compete against each other. Second, corporate governance of SOEs must be modernized so that the public resources entrusted to them are efficiently used. Third, regulations should be reassessed so that the potential competition distortions they might entail are minimized and they are shielded from rent seeking activities by the different stakeholders. Finally, the chapter examines how public assets could be better managed.

2A. Addressing Competitive Neutrality in MENA⁹²

Markets work best when they are competitive. Competition fosters cost reductions and innovation and promotes productivity growth. It rewards efficient producers—which helps ensure that resources are properly allocated, costs and prices are minimized, and consumers and other final users are best served.

But competition can occur only when all firms play by the same rules, when there is, in the sports-oriented parlance of economists, a level playing field. That means governments must ensure *competitive neutrality* so that no firm—whether a state-owned enterprise (SOE) or a private one with political connections—gains an advantage by virtue or what or who they are.

Competitive neutrality initiatives directly foster mechanisms to guarantee that no undue market advantage is granted to direct government participation in markets—through SOEs.

When there is strong state participation in the economy, as in the MENA region, it is critical to ensure a level playing field for all market players, for several reasons. First, SOEs, especially those that lose money, often burden the public budget, and the effect can be magnified if political interference reduces the incentives to pursue efficiencies and drives rent-seeking behaviors. Second, SOEs tend to crowd out private investment when they operate in sectors where private business is viable⁹³. Finally, SOEs typically enjoy certain privileges (such as access to finance not always available to private firms or antitrust exemptions) that distort market outcomes.

Evidence suggests that SOEs have more market power than other firms. A World Bank study of SOEs in China showed that those owned solely by the state had higher markups (the difference between costs and sales price) than other firms.

⁹² This section was prepared by Graciela Miralles Murciego with co-authors Georgiana Pop and Azza Raslan. Guidance was provided by Tania Begazo Gomez. The section builds on the competition policy framework developed by the World Bank Group Markets and Competition Policy team, notably the framework for analyzing competitive neutrality and SOE effects on markets.

⁹³ Private sector viability is based on the ability of private companies to offer a given good or service on a commercial basis. Private operators could also offer non-commercially viable services, such as universal postal services, if adequately compensated by the state.

Markups are generally used as a proxy for the level of competition in a market. Competition limits the markup ability of a firm.

In addition to interacting with players in their own market, SOEs provide goods and services to downstream markets and purchase inputs from upstream markets, thus affecting the entire value chains in which they participate. Moreover, even completely unrelated value chains can also be affected by SOEs that obtain privileged access to specific physical or financial inputs or influence government economic policy through successful lobbying. (See Box II.9).

Box II.9. Flexing muscle

The market power of SOEs can extend up and down the value chain.

Upstream

In Egypt, the Sugar and Integrated Industries Company, controlled by the Ministry of Supply and International Trade, is the holding company for all sugar mills in the country. Government mills set the prices paid to farmers for their harvest. It bases those prices not only on market conditions, but also takes into account farmers' income and competitiveness with imports.

Own Market

Mauritania created the Société Mauritanienne de Produits Laitier (SMPL) to achieve self-sufficiency in milk production and to produce all manner of dairy items. But the nascent market for cheese in the country cannot accommodate both SMPL and private producers. There is a risk that SMPL's government status, which confers easier access to credit, will crowd out private cheese producers, who have no such credit advantage.

Other Markets

The easy access to credit from state-owned banks that SOEs enjoy in Vietnam allows them to soak up so much available credit that small- and medium-sized enterprises (SMEs) cannot find financing. In the early 2000s only 20 percent of loans to SMEs came from financial institutions. The rest came from informal sources such as family and friends.

Sources: Assessment of Egypt's Sugar Market (WBG 2016 Presentation); Mauritania: Competition Policy for a Diversified Economy. Washington, DC: World Bank 2018; See Competition Policy in Vietnam. Washington, DC: World Bank. 2015.

▸ Principles of competitive neutrality

Governments should be guided by **two overarching sets of principles** when acting to achieve competitive neutrality: one set deals with firm behavior and the other covers the broader business climate at the sectoral, cross-sectoral and regulatory level (see Figure II.9).

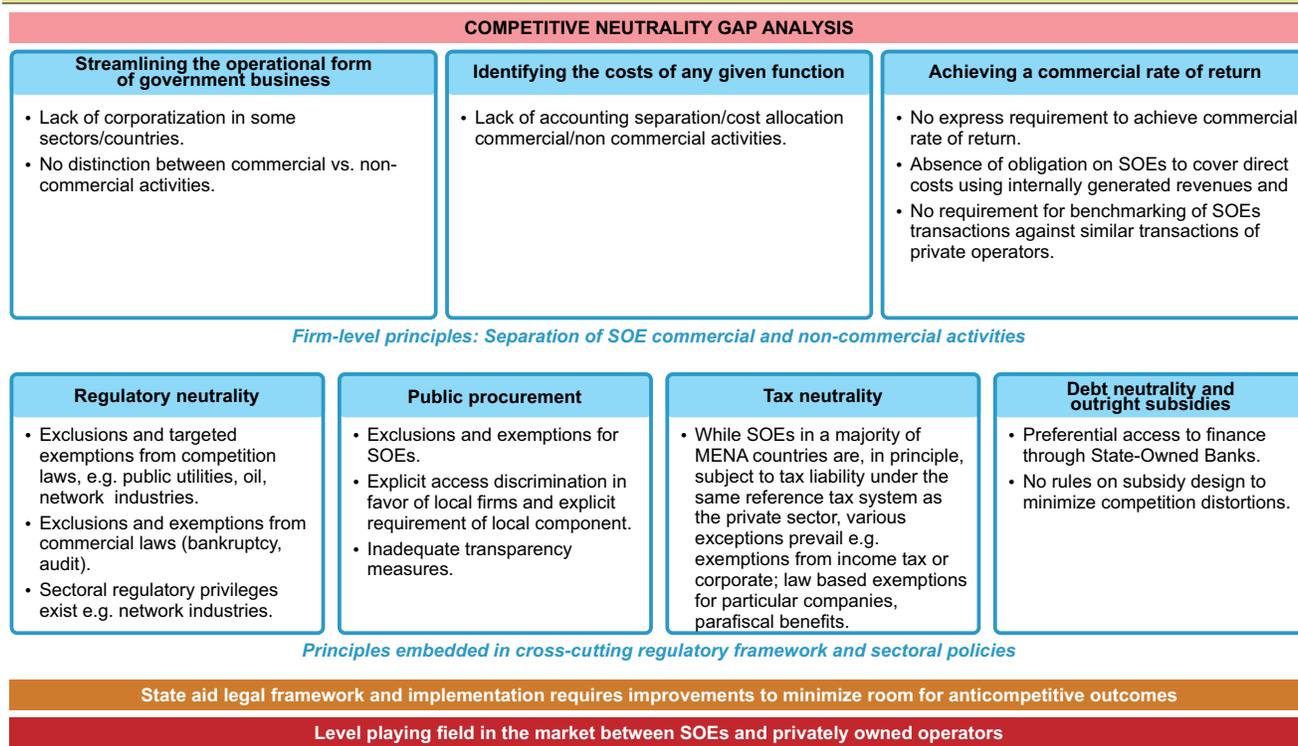
At the **firm level**, the principles require that:

- An SOE's commercial activities, those in which they compete with private companies, and non-commercial activities, those that provide a public service, be separated and the costs of each identified and properly

allocated. That will make it difficult for an SOE to subsidize its commercial operations with the public funds it receives to support its non-commercial operations.

- SOEs must be required to earn a rate of return on commercial activities comparable to that earned by private companies.

Figure II.9. Competitive Neutrality Framework Applied to the MENA Region



Source: World Bank Group's Markets and Competition Policy Team elaboration based on public information on 18 MENA countries as of August 2019.

At *the broader level*, economy-wide principles call for neutrality in taxation, regulation, access to credit, and public procurement, and for minimal direct or indirect subsidies to an SOE's commercial activities because they can create distortions.

While effective implementation of competitive neutrality is important to decrease the risk of anticompetitive behavior and economic distortions from SOEs (See Part I, section 1A "Making MENA Markets Competitive" and section 1B "Competition and Rule of Law Go Hand-in-Hand"), legal and regulatory deficiencies in MENA countries result in economies that often lack competitive neutrality.

› Competitive neutrality at the firm level in MENA

Separation of commercial and non-commercial activities. No MENA country requires an effective separation between the commercial and non-commercial activities of an SOE, although some competition laws acknowledge the different activities by limiting legal authority to the commercial activities of SOEs (Morocco).

Some countries have adopted international accounting standards (including Jordan, Kuwait, Lebanon, Oman, Qatar, United Arab Emirates, and Yemen). But only in Morocco and Tunisia are firms required to identify and properly allocate costs and in no country is there a clear requirement to separate costs and revenues related to commercial and non-commercial activities of SOEs. A few SOEs have done so on their own. For example, the Moroccan public airline has different accounting lines for unprofitable routes served on the basis of agreements with several regions to ensure connectivity.⁹⁴

Earning a profit. No MENA country requires SOEs to show a positive rate of return—whether calculated on net present value or internal rate of return (IRR)—measures typically used to determine the rate of return on investment.⁹⁵ When an SOE is entrusted with public service obligations, the rate of return on capital is based on the internal rate of return (IRR) that the undertaking makes on its invested capital over the duration of the period during which it performed those public service obligations. Moreover, many countries in the region report overall losses related to SOEs, but absent a clear separation between commercial and non-commercial activities, there is no way to assess whether the commercial activities of an SOE are profitable.⁹⁶

► Competitive neutrality at issue at the economy-wide level in MENA

In the MENA region there are as many failures to achieve competitive neutrality at the broad level sectoral or multi-sectoral level as at the firm level.

Tax neutrality: Public and private business activities should be treated equally under tax law. In Algeria, Iraq, Jordan, Kuwait, Libya, Qatar, Syria, Saudi Arabia, Tunisia, and Yemen, SOEs are theoretically subject to the same tax system as private companies. Yet, exemptions from corporate income taxes persist. Non-incorporated operations in Egypt and Kuwait, are tax exempt—for example, when the state offers services directly through a ministry. In Lebanon and Libya, SOEs are exempt from the income tax law. SOEs in the oil sector enjoy tax privileges in Bahrain and Oman.

Debt neutrality and outright subsidies: Access to credit is important to most business enterprises and if the playing field is to be level, private companies and SOEs must have equal ability to obtain financing and at the same terms. In most MENA countries, SOEs tend to enjoy debt financing on preferential terms and can get subsidies unavailable to private companies. In Jordan, the Government provides support to key SOEs, mainly to the National Electrical Power Company (NEPCO) and the water authority, including bond guarantees for NEPCO since 2011 to ensure continuous power supply.⁹⁷ In the UAE, reports show that selected SOEs have received capital infusions and preferential treatment from the government. Lack of rules on subsidy design to minimize competition distortions can further exacerbate potential market distortions.

Regulatory neutrality: Public and private business should, as much as possible, conduct their activities under the same regulatory environment to avoid regulatory advantages for SOEs that distort competition. Nevertheless, Algeria, Djibouti,

⁹⁴ See Morocco Country Private Sector Diagnostics: A second generation of reforms: Boosting private sector growth, job creation and skills upgrading, (World Bank Group 2019, forthcoming).

⁹⁵ For a detailed explanation of both net present value and internal rate of returns, see the EU Commission: Guide to cost-benefit analysis of investment projects, Structural Funds, Cohesion Fund and Instrument for Pre-Accession, 2008.

⁹⁶ These include countries that do not disclose financial statements such as Syria, Libya and Iran to those with mixed results such as Morocco which has a mix of financially sustainable and non-sustainable SOEs.

⁹⁷ U.S. Department of State (2017).

Oman, Qatar, and Saudi Arabia exclude SOEs from the competition law. Others grant exemptions. These exemptions may be on case-by-case, as in Egypt and Tunisia⁹⁸; target certain categories of SOEs, such as utilities in Egypt, Kuwait, Syria and Tunisia; or even, as in the UAE, cover total sectors such as telecommunications, financial services, and oil and gas. Other economy-wide regulations that offer differential treatment to SOEs include commercial and company laws in Tunisia; audit law in Saudi Arabia; and bankruptcy laws in Kuwait. In addition, sector-specific regulation also provides exemptions to SOEs—including electricity in Morocco, oil and gas in Bahrain, and banking in Lebanon. In some sectors, SOEs enjoy legal monopolies—for example, port operations in Kuwait and air transport and telecom in Egypt. Moreover, public bodies often act both as regulators and operators: through regulatory agencies that provide services themselves or through SOEs with regulatory powers. For example:

- In Lebanon, the Ministry of Telecoms provides services even though it also acts as a regulator.⁹⁹
- In Morocco, the SOE in charge of developing and managing highways is also simultaneously an owner, administrator, manager and supplier.
- In the UAE, the publicly owned electricity supplier—responsible for generation, transmission and distribution—can also set prices and connection fees.

Public procurement: To ensure the level playing field and also to facilitate the entry of competitors in the public contract market, procurement policies and procedures should be transparent, competitive, and non-discriminatory, especially when it concerns the access of SOEs to public contracts and their treatment during public procurement. In principle, SOEs should receive no preferential treatment and participate in bids on government contracts on an equal footing with private enterprises. But many procurement laws in the MENA region reduce the competitive nature of tenders—such as by requiring national content, as well as giving explicit preferences, issuing overall exemptions from the public procurement rules or granting specific benefits to SOEs. In Egypt, the 2018 public procurement law does not cover SOEs and permits direct agency-to-agency contracting with proper approval. In Jordan, Qatar, and the UAE, preference is given based on local components or nationality. In Qatar, Qatar Petroleum is excluded from the tender law. In Jordan, each SOE has its own tender rules, and in Algeria SOEs are allowed to develop their own tender rules in accordance with freedom of access, equality and transparency principles.

▸ Benefits of competitive neutrality

Properly deployed, competitive neutrality would reduce support for the inefficient SOEs and minimize barriers to entry for potential competitors that come about because of subsidies to investments to specific SOEs or regulatory protection for incumbent public companies. Similarly, the access of the SOE to public contracts and their overall treatment during public procurement should be open, transparent and non-discriminatory. On the other hand, regularly reviewing the role of the state in the economy can also ensure that SOEs operate in those areas or sectors where private sector companies are unwilling or unable to operate.

⁹⁸ In Egypt exemptions can be granted to hardcore cartels if they achieve economic efficiency that benefits consumer more than reduced competition hurts. In Tunisia, the relevant minister can set the prices for no more than six months to deal with market irregularities such as sudden excessive increase or collapse in prices.

⁹⁹ OECD (2013), p.78.

2B. State-Owned Enterprises Should Emulate Private Sector Governance¹⁰⁰

Policymakers, private businesses, and economists, among others, are increasingly demanding that state owned enterprises (SOEs) be competitive and create value—as do private corporations.

The demand is justified because SOEs are major contributors to both developed and developing economies. From a global perspective, SOEs are everywhere. They are found in industries as diverse as manufacturing, utilities, banking, energy, telecommunications, natural resources, and services (tourism, for example). According to the International Finance Corporation (IFC, 2018), SOEs account for 20 percent of global investment and contribute up to 40 percent of domestic output. SOE contributions are more prominent in developing economies, including in the Middle East and North Africa (MENA). In fact, in MENA, SOEs are fundamental to the economic architecture of the region. They operate in a range of sectors—such as hydrocarbon and electricity, transportation, telecommunications, postal services, manufacturing, finance, and real estate (see Table II.4).

The importance of SOEs in their economies makes it imperative that countries, including those in the MENA region, give SOE reform first order importance to unlock the full value of these enterprises to the economy and to the society at large. Strengthening corporate governance is central to any reform of SOEs, and the push to undertake that task has gained momentum over the last two decades. Landmark governance reforms undertaken in the United States following spectacular accounting scandals and, more recently, the global financial crisis, have pushed the issue globally. So have international organizations, including the World Bank (2014b) and OECD (2013, 2018), which are promoting best governance practices by partnering with countries.

Table II.4. SOEs Share of Key Sectors in 16 MENA Economies, 2013

	<i>Percent of firms in sector</i>
Transportation	16
Electricity and Gas	10
Telecoms	9
Finance	23
Manufacturing	13
Primary Sectors	14
Other Utilities	6
Other Activities	5
Real Estate	4

Source: OECD Report (2013); <http://www.oicexchanges.org/docs/third-meeting-istanbul/mena-soes-eng.pdf>

The OECD guidelines on corporate governance have been influential in globalizing corporate governance. They identify key topics that must be tackled by any effort to reform governance of SOEs and suggest avenues for action (see Table II.5).¹⁰⁰

Inefficiently run SOEs, which are characterized by poor governance, detract from economic performance and become a drag on society. Moreover, such entities impose fiscal burdens and risks to the state. SOE inefficiency in the provision of services and inputs imposes increased costs of doing business on the private sector. There are also opportunity costs, because the resources squandered by inefficient and poorly run SOEs could have been channeled to productive use elsewhere, particularly in the private sector.

Thus, the primary reason for corporate governance is the separation of ownership and control, and the prevention of agency conflicts among parties of the corporate enterprise—equity holders, creditors, management, and other

¹⁰⁰ This section was authored by Lemma W. Senbet, William E. Mayer Chair Professor of Finance at the Smith School of the University of Maryland, College Park and consultant at the World Bank. Opinions expressed in the article are of the author and should not be attributed to the author's affiliations—the World Bank and the University of Maryland.

stakeholders, including employees, customers, and suppliers. This section discusses corporate governance mechanisms that have evolved over time in the private domain and then examines their applicability to the governance of SOEs. Private sector governance principles can serve as a benchmark against which governance of SOEs will be judged. Good corporate governance creates value. Bad governance destroys value (Gompers, and others, 2003; Aggarwal, 2010; Heo, 2018).

Table II.5. OECD Corporate Governance Guidelines

<i>Topic</i>	<i>Guideline</i>
Rationales for state ownership	The state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.
The state’s role as an owner	The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.
State-owned enterprises in the marketplace	Consistent with the rationale for state ownership, the legal and regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.
Equitable treatment of shareholders and other investors	Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognize the rights of all shareholders and ensure shareholders’ equitable treatment and equal access to corporate information.
Stakeholder relations and responsible business	The state ownership policy should fully recognize SOEs’ responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.
Disclosure and transparency	State-owned enterprises should observe high standards of transparency and be subject to the same high-quality accounting, disclosure, compliance and auditing standards as listed companies.
The responsibilities of the boards of state-owned enterprises	The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

Source: OECD (2015), OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264244160-e>

One value of good corporate governance is that it enhances access to external finance at reasonable terms. Inefficiently governed SOEs would find it hard to access financial markets (domestic and global) and, therefore, would either have to change their processes or go out of business. But because they have access to government funds, SOEs face no external financial discipline. Instead of going out of business, badly run SOEs are kept afloat by privileged access to government funds and possibly other types of inputs. This should warn reformers that the disciplining effect of sound corporate governance works only if the external environment is conducive to such an outcome and SOEs do not receive advantages private competitors do not. Competitive neutrality must be ensured (see section 2A “Addressing Competitive Neutrality in MENA”).

› **Incentives differ between private and state-owned enterprises**

As Table II.6 demonstrates, there are important differences between SOEs and private enterprises, giving rise to incentive conflicts among differing parties in the corporations. The immediate challenge facing SOEs is the need to balance commercial and political objectives. In the private sector, incentive issues concern management and shareholders. In SOEs there are additional players—politicians and bureaucrats who may be guided by their own self-interests. That means SOEs are at risk of abuse by authorities and politicians (see Fan, 2007). Moreover, SOEs do not have a range of

instruments to incentivize management and employees—unlike private sector enterprises, which can use market-based mechanisms, such as stock options and bonuses to motivate behavior in the best interests of the firm (see Faulkelender and others, 2010).

Table II.6. Essential Differences between SOE and Private Enterprise

	<i>SOE</i>	<i>Private Enterprise</i>
Objective	Multiple: commercial and non-commercial	Enterprise value or shareholder wealth maximization
Ownership	Government (Delegated government unit/s)	Shareholders
Other Stakeholders	Customers, suppliers, employees, creditors, communities	Customers, suppliers, employees, creditors, communities
Market Discipline	Very limited or none (Unlisted SOE);	Subject to takeover; shareholder activism
Incentive Pay	For listed SOE – bonus and other performance incentives; For unlisted incentive pay rare	Use of stock grants and options
Primary Agency/Incentive Conflicts	Management, Shareholders, Politicians	Management, Shareholders

Private sector governance principles can serve as a benchmark against which the governance of SOEs can be judged. There are various areas of corporate governance that can be applied in a reform of SOE governance, with the board being the primary one (John and Senbet, 1998). Others include a well-designed executive compensation structure, shareholder activism (direct governance), markets for corporate control, and institutional and concentrated shareholdings (Morck and others, 1989; Senbet, 2011). Over the years, these mechanisms have been reformed in response to massive governance failures, particularly in the United States (see Box II.10).

Box II.10. Massive U.S. Frauds Spawned Corporate Governance Reforms

In the 1990s, a wave of accounting fraud in the U.S. technology sector resulted from failed corporate governance. In particular, there was a flagrant board capture by the CEOs, partly enabled by an external auditing firm, Arthur Anderson, which had conflicts of interest with clients. The fraud led to the notorious demise of Enron and World.com. In response, the landmark Sarbanes Oxley (2002) legislation was enacted. It required, among other things, that corporate audit committees and the external auditor be independent. In the aftermath of the 2008 global financial crisis, it was recognized that the collapse of large financial institutions, including Lehman Brothers, resulted from distorted incentives such as aggressive equity-based executive compensation contracts. Those contracts included generous option grants, which led to excessive risk-taking. In response, the Dodd-Frank Act was enacted in 2010, requiring such corporate governance reforms such as greater transparency of executive pay. Securities and Exchange Commission rules now require full disclosure of executive compensation and its structure.

A number of areas must be dealt with in any reform: delineated ownership, incorporation and board appointments, the independence and composition of the board, the board committee structure, the separation of the board chair and the chief executive, and market discipline.

SOE ownership. Any reform of an SOE's corporate governance begins with clean delineation of its ownership structure. SOEs are fundamentally business enterprises whose ultimate owners are the citizens. The best interests of the owner

citizens are served if SOEs operate with the same efficiency and transparency as do their peer private corporations. This is a basic rationale for separating SOEs from the government by transforming them into limited liability corporations. In addition, incorporation can help minimize political interference because it serves as a powerful signal to politicians, civil servants, and the public at large that the SOE is a business enterprise.

The next question is who should represent the government (ultimately the citizens) as shareholder. The central government has to delegate that representation to a separate entity. Ideally, the government delegate should be an institution, existing or newly created, that performs the role of a holding company and protects the overall interests of the citizens, thanks to its broad view of the economy and its development challenges. That means line ministries, with their narrower focus, should not be selected to represent shareholders.

Nevertheless, as Table II.7 shows, the decentralized owner in most MENA countries is a line ministry (OECD, 2018). Morocco has created an agency that coordinates ministries. In principle, the coordinating agency meshes the shareholder functions of the line ministries for the collective public interest.

Table II.7. Categories of SOE Ownership in MENA		
<i>Ownership Categories</i>	<i>Coordination</i>	<i>MENA Countries</i>
Decentralized ownership Ownership by line ministries	not applicable	Algeria, Palestinian Authority, Djibouti, Iraq, Jordan, Lebanon, Mauritania, Oman, Qatar, Syria, Tunisia, Yemen
Decentralized ownership Coordinating Agency	Coordination across ownership entities, particularly line ministries	Morocco
Decentralized ownership A segment of SOE portfolios held by central state holding company(ies)	not applicable	Saudi Arabia, Bahrain, Egypt (hybrid model), United Arab Emirates, Kuwait

Source: Online review by OECD Secretariat of publicly available information on the state ownership arrangements of known SOEs in the region.

But the coordinating role in Morocco is delegated to the Ministry of Economy and Finance. While this centralizes the ownership function, it is unlikely that it would overcome the potential conflicts of interest that could arise from a sectoral ministry and the society at large. An alternative form of the coordinating agency is the investment company, which has been adopted by such countries as Malaysia and Singapore to manage the government’s strategic stakes in domestic SOEs and to invest in sectors that could aid the country’s economic growth and competitiveness. Several MENA countries have adopted a similar ownership vehicle which is often called a national wealth fund.

Incorporation and Empowerment of SOE board. Granting full autonomy to the SOE as a limited liability corporation is only the first step in reforming SOE corporate governance. Unlike their counterparts in the private sector, SOE boards can find it hard to operate totally independently in directing and overseeing their companies. Board members are appointed by the government and risk political interference from the government, which could limit the authority of the board to oversee corporate strategy and to appoint senior executives. That means explicit government empowerment of the board is essential for any reform of SOE corporate governance. In particular, there should be clear-cut recognition that it is the board (not the government) that appoints and fires the chief executive officer (CEO) and other top executives. When the board is empowered to appoint the CEO and top executives, the scope for government interference is much reduced.

Board Composition and Dual Independence. Government empowerment of the SOE board alone does not fully reform governance. The SOE board chair should be independent. As in private companies, independent directors should have

no economic relationship—such as providing consulting or other services—with either corporate executives or the corporation itself (Horstmeyer, 2019). But SOE boards face a challenge that private sector boards do not. Not only must they be independent of capture by the CEO and top executives, they must ensure their independence from the public sector—such as from government officials, elected officials, and party leaders. As SOE board independence has gained more attention over the years, a number of countries have mandated that no politician or public official can serve on an SOE board (Wang, 2018)—a policy consistent with the OECD guidelines (2015) that stipulate that non-executive board members (that is, independent/outside) should be recruited from the private sector.

Board Committee Structure. In practice, as with private sector corporate boards, much of the governance work of an SOE is done at committee levels rather than at the full board. The governance value of the committee structure is well documented (Klein, 1998). Over the past two decades, audit committees of boards have received particular attention and gained prominence—largely because of massive accounting scandals associated with the collapse of celebrated companies, such as WorldCom and Enron. Generally, audit committees have added oversight of corporate risk management to traditional accounting and internal auditing matters. Top risks are not only financial and operational but also include, among other things, cyber security.

Separation of SOE Board Chair from CEO. Genuine reform of the SOE corporate governance may require complete separation of the board chair from the CEO. Separation has been a major reform pushed by institutional investors. The rationale is straightforward: one of the most important duties of the board is hiring (and firing, if necessary) the CEO and top executives. There is also a conflict of interest in setting the CEO pay if the CEO is also board chair. Moreover, when the position is shared, it can lead to board capture by the CEO—or even to the creation of an imperial CEO. Although the government grants autonomy to the SOE through corporatization, in the presence of an imperial CEO, government authoritarianism can be transformed into corporate authoritarianism.

While the case for separation of roles is compelling when there is an imperial CEO, such separation may destabilize “non-imperial” CEOs who are otherwise properly incentivized. Academic research is unsettled on this issue, which may explain why a significant number of S&P companies in the United States still have CEOs who are also board chairs. There has been more separation of roles between board chair and CEOs in Europe.

Market Discipline. For SOEs listed on stock exchanges, market discipline becomes an additional instrument of corporate governance. Signals from the stock market about company underperformance can create incentives for outside arbitrageurs to attempt a takeover, which puts pressure on the company to increase efficiency and make improvements. These improvements could include firing under-performing management. In practice, the threat of a takeover is often sufficient to engender better efficiency and better governance. In this way market discipline can act as a complement to board governance (Weisbach, 1988; John and Senbet, 1998)

For those SOEs not listed on exchanges, partial or full privatization allows access to the benefits of corporate governance arising from market discipline. Privatization through a stock exchange requires a market supported by strong regulation and supervision, as well as good corporate governance (Senbet 2018). Moreover, the accounting and auditing systems should conform to generally accepted principles. Auditing and accounting firms supply vital information to the stock market. In fact, stock exchanges have listing requirements that go to the heart of corporate governance and transparency. This is one other way market systems help improve corporate governance.¹⁰¹

¹⁰¹ States also own banks. Because banks are subject to government regulation whether they are SOEs or privatized, the corporate governance reforms have to interact with the reforms of banking regulation. The question is: To what extent are private sector corporate governance principles applicable to an efficient design of banking regulation? It turns out that governance through properly designed incentive features of compensation for bank executives can be used to design an incentive-based regulation (John, Saunders, Senbet, 2000).

Shareholder activism can help guard against political interference in the functioning of SOEs. Shareholders can engage in organized campaigns to ensure that listed SOEs are subject to the same corporate governance principles as their private counterparts. In more advanced economies, particularly in the United States and Canada, the shareholder movement has led to rules that give stock owners a say on executive pay, putting pressure on board compensation processes. Direct shareholder action is an additional instrument of corporate governance brought about by the power of capital markets. This is also an additional rationale for share issue privatizations of SOEs and development of well-functioning financial systems, including stock markets.

Finally, corporate governance may be poised to move from an era that is driven by shareholder primacy to one of stakeholder primacy. In August 2019, the Business Roundtable, which represents most influential corporate CEOs, issued a surprising statement that declared stakeholders' interests should rank supreme in corporate governance. The statement moves U.S. executives closer to the multi-stakeholder view held outside the United States (Gande, John, Senbet, 2019). There is real potential for corporate governance practices to converge globally and fully, resulting in a unified global code of corporate governance.

2C. Small Steps Can Protect MENA Economies from Capture by Elites¹⁰²

If countries in the Middle East and North Africa (MENA) are to diversify their economies to make them more competitive, resources must flow to those firms that can make the best use of them to create more jobs, especially for young people.

But in many markets in the MENA region, a few firms enjoy an artificial and unfair competitive advantage because of their connections, while most firms struggle to enter the markets and grow or are forced to remain part of the informal sector¹⁰³. The result is a skewed distribution of productive resources that is a major cause of the high unemployment rates—which range from 15 to 25 per cent.

The cost of doing business is artificially reduced for the well-connected firms, which have no incentive to innovate and be more productive.¹⁰⁴ The cost of doing business is artificially increased for outsiders, who are prevented from competing on fair grounds. This results in a low productivity equilibrium and explains the slow growth and job creation in the region over the past decades.

Leveling the playing field and ensuring an optimal flow of resources to the most productive and promising firms is crucial to boosting economic opportunities in the region. But the stranglehold the elites often have on policymaking (so-called policy capture) and economic regulatory decisions make it virtually impossible to guarantee equal treatment for all. However, there are ways to help level the playing field and make private sector policies and practices resistant to capture, privilege and corruption.

¹⁰² This section is authored by Meriem Ait Ali Slimane.

¹⁰³ Schiffbauer and others (2015).

¹⁰⁴ Aghion and others (2001).

▸ Tackling privilege

A February 2018, World Bank report, “Privilege-Resistant Economic Policies in MENA,”¹⁰⁵ provided simple techniques for tackling privilege at different levels and along the policymaking cycle to enhance private sector development.

The first level to address is policy formulation—where well-connected businessmen can influence policies to their advantage. This phase is more prone to high-level capture than others, but simple moves can create hurdles for the well-connected individuals and even help level the playing field. Publishing draft policies, laws, bylaws and even ministerial decisions before they are adopted would allow the public and concerned stakeholders to comment and propose alternatives. Prior publication can not only expose policies custom-made to help one or another firm or business person, it can also provide policymakers with different perspectives, which can improve the quality of the regulation. Jordan, for example, has taken steps toward improving the predictability of business regulations (see Box II.11).

Box II.11. Jordan revamps its regulatory and policy making process

Jordanian businesses, as do firms in many MENA countries, suffer from unpredictable regulations. Requirements and fees that change frequently, with no consultation or prior notice, make for high adjustment costs that hurt the private sector. Moreover, the lack of accessibility to laws, bylaws, and other regulations in official databases opens the door for interpretation, discretionary enforcement and privilege-seeking behavior. Besides, new policies, laws and regulations are often enacted without prior discussion with stakeholders, which often leads to sub-optimal results because the new legal frameworks are not informed by the experience and knowledge of stakeholders. Even lower-level officials charged with implementation are not informed of changes, which causes many difficulties. This unstable regulatory environment deters investment as private firms seek to minimize risks of losses.

In April 2018 Jordan introduced a new code governing how new regulations affecting the private sector are conceived and issued. In September 2019, six Ministries and agencies undertook a pilot program using the new process of online consultation, prior notice, regulatory impact assessment and delayed application to provide firms with the time to adjust.

The new process requires that draft changes be published on a Ministry’s or agency’s website for public consultations—60 days in advance for Laws, 30 for bylaws, 15 for instructions, and 7 for decisions. It also requires publication of responses to the feedback and official publication of the final versions. There is also a mandated delay until the published change takes effect, depending on the level of regulation. An impact assessment should take place to estimate the economic impact of the policies and regulations.

There are several ways to make day-to-day interactions between businesses and government less prone to capture by the privileged. These interactions permit officials’ discretion in how they deal with businesses, which opens the door to privilege and corruption. They include accessing public land, credit, investment incentives, as well as obtaining permits and paying taxes. Two key areas—customs (international trade) and public procurement—are vulnerable to elite capture. MENA countries are taking steps in these areas to reduce privilege and level the playing fields for businesses.

International Trade. There are myriad ways the elites can benefit from the exchange of goods and services between countries. Exclusive import licenses are one of them. They discourage competition and permit the holders to gain excessive profits. Licenses must be impartially auctioned and be time-limited to ensure a level playing field. In general,

¹⁰⁵ Mahmood and Ait Ali Slimane (2018).

the more import restrictions, non-tariff barriers and special regimes are in place, the more rent-seeking behavior and corruption will occur. Moreover, complicated trade and customs policies open the door for interpretation, discretion and arbitrariness. Full electronic processing of customs declarations drastically reduces human interaction and therefore the possibility of the types of negotiation that lead to corruption. Such automatized processing must also include a risk-based approach to inspections, in which computer software, not individual customs agents, choose the containers to inspect depending on their risk profile (see Box II.12). Although human intervention should remain possible, it should not be systematic.

Box II.12. Algeria modernizes customs inspection

In Algeria, more than 70 percent of containers are physically inspected by customs agents to detect a small amount of fraud. The current approach—also used in many MENA countries—is costly, inefficient and open to abuse through human interactions. Since 2017, a World Bank project has supported the modernization of Algerian customs through the co-design of an innovative algorithm to replace the current human-based system that selects containers for inspection. The new algorithm—put in place in 2019—will automatically select containers based on their risk profile (such as origin of the goods, origin of the ship owner, type of products, and activity of the importer). The algorithm uses artificial intelligence to learn fraud patterns and predict them thanks to data linked to the containers.

This digitization effort also improves efficiency by reducing and better targeting the number of physical inspections and reducing opportunities for discretion, arbitrariness, negotiation, privilege, and corruption.

Public procurement. Selling goods or services to the public sector is the most important business for small-to-medium sized enterprises (SMEs) in many countries. Transparent public procurement policies and practices supported by appeal and redress mechanisms can make it possible for most SMEs to benefit from this large market. Opaque and complicated public procurement systems result in barriers to entry to new players and reduce competition. As a result, non-connected firms are confined to limited markets, low-growth, low-productivity, and low-innovation activities, which inhibits their ability to create jobs. Jordan is overhauling its public procurement framework to make it less prone to favoritism (see Box II.13).

Box II.13. Jordan digitizes public procurement

In Jordan the public procurement system was fragmented, without a clear regulatory and oversight function, and lacked an independent complaint resolution mechanism. In February 2019, Jordan modernized and digitized its public procurement operations by: i) establishing a central policy and oversight unit and an independent complaints-handling unit; and ii) adopting an e-procurement system, in line with the government's digitalization policy.

The new e-public procurement system—supported by World Bank technical assistance—has been made mandatory in the main central procuring agencies in Jordan and is being generalized to target 100 percent of public procurement contract award results published online.

This new digitized system will improve transparency and spur competition and market contestability by easing the entry of new players, improve efficiency, and reduce the cost of handling public procurement contracts. It will also enable more accountability through the complaints mechanism.

The prosperity and social cohesion of the MENA region rests on its ability to transform its public administration to better deliver services to the private sector to provide opportunities to a young and increasingly well-educated labor force. One way to support the transformation is to take steps such as those outlined above to reduce the influence of the privileged few in the operation of the economy.

2D. Public Assets Are an Untapped Source of National Wealth¹⁰⁶

When Singapore and Jamaica achieved independence in the early 1960s, both island nations had roughly the same population, life expectancy, and GDP per capita.

Today the comparison is less apt. Not only has Singapore's population grown three times faster than Jamaica's, its per capita GDP is 10 times bigger, and life expectancy is about 9 percent higher. Against all odds, the tiny Asian nation with no significant resources, not even the capacity to generate basic utilities such as water and electricity, has thrived thanks to innovative and bold thinking.

There are many reasons to explain why Singapore performed so much better than Jamaica over the succeeding half century—including the development of human capital and a strong rule of law—but a major source of Singapore's economic attainment was the creation of good economic institutions and the effective use of public assets.

Proper use of public commercial assets has been a core component of Singapore's strategy to move the economy from developing to developed status in a single generation. Singapore's founders introduced an innovative and unorthodox separation of economic policy from the management of public assets. At a time when free market capitalism was seen as essential to rebuilding the post-World War II global economy and creating full employment, Singapore opted to go the other way and recognized that a government, just like a corporation, has a balance sheet with both assets and liabilities that need active management. Jamaica, like most other governments around the world, many endowed with plentiful natural resources, continued to manage its economy as if it only consisted of a current cash budget and a stock of public debt. The founding fathers of Singapore incorporated portfolios of assets inside public wealth funds, delegating to professionals the responsibility for managing public commercial assets in holding companies that introduced private sector discipline and used governance tools borrowed from the private sector.

▸ Professionalizing Public Financial Management

Today, most governments around the world have delegated public management of several core financial operations to separate professional institutions—including government debt to a debt management office and interest rates to an independent central bank.

Similarly, many governments in the Middle East and North Africa (MENA) have also delegated the management of surplus revenue from exports to sovereign wealth funds (SWFs). These SWFs—such as the Kuwait Investment Authority (KIA) and

¹⁰⁶ This section was authored by Dag Detter.

Abu Dhabi Investment Authority (ADIA)—have generated wealth for society and future generations by investing surplus oil revenue in well-developed international stock markets and in real estate in attractive developed markets.

High hydrocarbon prices have benefited oil exporters over the past decade both directly, by supplementing tax revenues with income from oil exports, and indirectly, through the dividends from the SWFs. In addition, public sector balance sheets have been bolstered by the continuous growth in the value of the SWFs. The proceeds have been used to modernize infrastructure and create employment.¹⁰⁷

Non-oil-exporting MENA economies also benefited—both from investments by oil-exporting economies and from the knock-on effects of a range of regional activities, including tourism, which bolstered the labor market. However, economic conditions deteriorated after the sharp fall in oil prices in 2014, leading to higher fiscal deficits. In addition, ongoing political conflicts have weakened investor confidence in the region. Foreign direct investment (FDI) has declined since the 2008 financial crisis and the 2011 Arab Spring.¹⁰⁸

The need to diversify economies and create additional government revenue is widely recognized across the region, as is the need to strengthen government balance sheets. The most obvious response would then be to look at the other commercial assets on the government balance sheet.

▸ Public Commercial Assets

Apart from natural resources, the public sectors in MENA countries own airports, ports, utilities, banks, and listed corporations. But the biggest asset for most countries is a large portfolio of real estate, whose value is several times that of all other assets—except, of course, national oil companies (NOCs). Excluding public parks and historical heritage sites, these government-owned commercial real estate assets account for a significant portion of each country's land. But governments often know about only a fraction of these properties, most of which are not visible on government accounts.¹⁰⁹

Operational assets owned at the national level are sometimes called state-owned enterprises (SOEs). Non-oil SOEs, although less valuable than the real estate segment, play a fundamental role in MENA economies because they often operate in important sectors upon which the broader economy depends—such as electricity, water, transportation, and telecommunication (see Figure II.10). For these reasons and others, the importance of well-governed SOEs cannot be overstated.

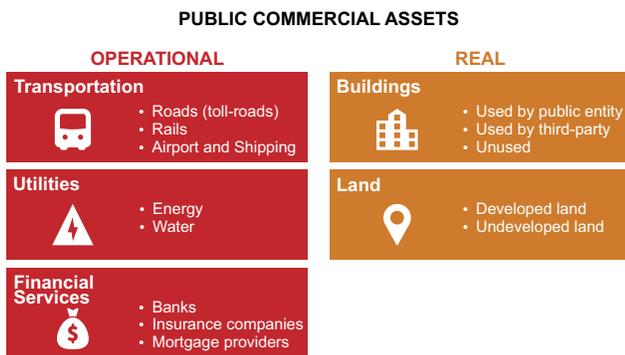
The upside of managing public commercial assets more professionally in the MENA-region is substantial.

¹⁰⁷ Fasano-Filo and Iqbal (2003).

¹⁰⁸ UNCTAD (2017)

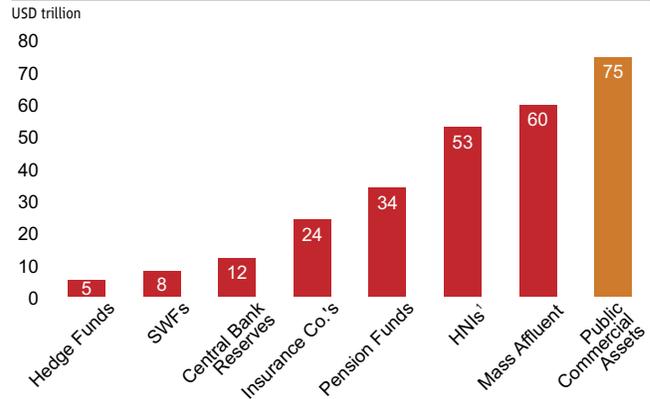
¹⁰⁹ Detter and Fölster (2018).

Figure II.10. Operational and Real Assets



Source: Detter and Fölster (2015).

Figure II.11. Value per Asset Segment



Source: World Bank, Detter and Fölster (2015); 1. High Net Worth Individuals.

▸ **The size of the prize**

The value of public assets is twice that of global stock markets—and twice global GDP, according to estimates from the International Monetary Fund (also see Figure II.11). But unlike privately held assets and businesses, public wealth is unaudited, unsupervised, and often unregulated. Even worse, it is almost entirely unaccounted for. When developing their budgets, most governments largely ignore the assets they own and the value those assets could generate.

Since modern accounting was invented about 700 years ago, corporations have had to develop high quality information for decision-making and for stakeholders to be able to hold them accountable.

Listed stocks are constantly scrutinized by armies of analysts, brokers, investors, regulators, tax authorities, and the media. The development of corporate governance systems and accounting standards has not only enabled capital market development but has also contributed mightily to the creation of the wealth we all enjoy today (see Box II.14).

Box II.14. Benefits of modern accounting and public financial management

Adopting accounting standards similar to those used by private companies and based on accrual accounting—which records income and expense when incurred rather than when cash changes hands—would be an important first step toward implementing a modern financial management system.

Most OECD countries now report on an accrual basis and show a balance sheet—which reports the value of assets and liabilities at a point in time that yields important information about financial health. But the majority still budget and appropriate on a cash basis, which means the balance sheet sits outside the budget process and for that reason is largely ignored.

continued on next page

Box II.14 continued

The absence of a proper balance sheet that is fully integrated into the budget distorts understanding of financial status because governments focus mainly on debt, without recognizing the value of the physical assets, using measures such as “net debt” or “debt/GDP” as key targets. That can lead to bad decisions—such as privatizing a water system to generate funds to finance an infrastructure investment rather than borrowing.

With proper accounting, governments would focus on net worth—the value of assets less liabilities, the measure used in the private sector, instead of on debt alone. With net worth as the official key target, an increase in debt to finance an investment is matched with an increase in assets. This would then create incentives to invest in government-owned assets rather than encouraging wholesale privatization—which may be for the wrong reasons and at the wrong price.

Poor or risky accounting practices can shake, and ultimately bring down, entire societies. Accounting affects us all, as becomes apparent whenever there is a financial crisis, be it for banks, corporates or governments.

So far, only New Zealand has introduced modern accounting and integrated its balance sheet with the budget, using it as a tool for its budgeting, appropriations, and financial reporting. Since the public sector reforms in the mid-1980s, New Zealand has achieved and maintained significantly positive net worth, where most comparable governments, such as Australia and Canada, or larger countries such as the United Kingdom and the United States have a negative net worth.

But the same progress has not been made by governments.

Creating fiscal space and strengthening the public sector balance sheet using public wealth could be a critical tool in strengthening public finances and generating growth across the MENA region.

Professional management of public assets could annually generate extra revenue equivalent to 3 percent of GDP, according to the IMF.¹¹⁰ That is almost 30 percent of the total taxes collected in the region.

▸ Institutionalizing the management of public commercial assets

Increasing reliance on debt to finance public expenditures has led governments to professionalize public debt management in a drive to minimize the costs of central government financial management without incurring excessive risk.

Similarly, independent central banks were created to oversee interest rates with the aim of keeping prices steady while politicians set broad economic policy goals.

In 1971, the recently independent state of Singapore created the Monetary Authority and delegated management of the asset side of its public sector balance sheet. Its commercial assets therefore became the management responsibility of professionals inside independent public wealth funds (see Box II.15).

¹¹⁰ IMF (2018b).

Box II.15. Sovereign vs national wealth funds

A Sovereign Wealth Fund (SWF) is primarily concerned with managing reserve liquidity, typically investing in securities traded on major mature markets. SWFs are designed to optimize a portfolio by trading securities to achieve balance between risk and returns. An example is GIC of Singapore.

A National Wealth Fund (NWF) is an asset manager, concerned with active management of a portfolio of operational assets. NWFs seek to maximize the portfolio value through active management including the development, restructuring, and monetization of the individual assets. An example is Temasek of Singapore.

Source: Detter and Fölster (2015).

Goh Keng Swee, the deputy prime minister of Singapore at the time, explained why Singapore chose private sector discipline and governance tools borrowed from the private sector to manage commercial assets: “One of the tragic illusions that many countries entertain is the notion that politicians and civil servants can successfully perform entrepreneurial functions. It is curious that, in the face of overwhelming evidence to the contrary, the belief persists.”¹¹¹

Since then Singapore’s wealth management funds—Temasek and the Singapore Government Investment Corp (GIC)—have helped fund the economic development of the city-state, while the Housing Development Board (HDB) has provided almost 80 per cent of its citizens with affordable and well-maintained public housing.

GIC is the sovereign wealth fund, the vehicle that helped professionalize management of the foreign reserves of the government, which is invested in financial assets outside of Singapore. But the public sector also needed a vehicle to manage its portfolio of domestic operational assets in a way that is recognized as the accepted international standard of asset management. In the private sector that vehicle is a corporate holding company with internationally accepted corporate governance and accounting standards. The professional management vehicle for commercial assets owned by the government is called a national wealth fund (NWF). There can be no professional management without such a vehicle. In Singapore this became Temasek.

The joint market value of GIC and Temasek matches Singapore’s public liabilities and its annual GDP and as such contributes to a positive net worth. As a result of this strong balance sheet, Singapore has consistently received the top credit rating—AAA—from the three main credit-rating agencies. Both funds deliver a significant surplus to the government.

Some MENA economies, mainly those in the Gulf Cooperation Council, have taken steps towards centralizing and consolidating strategically important SOEs into a state holding company. In Saudi Arabia, for example, the Public Investment Fund (PIF) has taken over ownership of major companies and maintains minority ownership in a range of other companies. Abu Dhabi is also taking steps to consolidate its holdings inside a state holding company. Egypt and Oman have made only nominal efforts to consolidate SOEs.

¹¹¹ Goh (1972).

None of the MENA economies, however, has comprehensively professionalized and consolidated the entire portfolio of operational assets as Singapore has.

While policymakers have focused on managing debt for decades, they have largely ignored the question of public wealth. In most countries public wealth exceeds public debt: managing that wealth better could help to reduce excess indebtedness while providing the basis for future economic growth.

The longstanding debate between those who argue for privatized economies and those who champion nationalization misses the point: what matters is the quality of asset management. When it comes to public wealth the focus should be on yield rather than ownership. Improvements in public wealth management could generate returns greater than the world's current combined investment in infrastructure. Improvements in the transparency of public wealth management could also help fight corruption.

› Professionalizing the management of public commercial assets

Government ownership has historically given rise to complex governance and regulatory risks that often prevented SOEs from creating optimal value for the economy. Inefficient SOEs and other public assets, such as real estate that remains underdeveloped or mismanaged create a drag on the economy and crowd out private sector initiatives and foreign direct investment. In the worst case, SOEs are used for political patronage or self-enrichment, which erodes the trust of citizens, international investors, and potential partners.

Government-owned companies and assets in MENA economies are active across a wide range of sectors—including electricity, gas, telecommunications, postal services, other utilities, finance, and transportation. Several MENA governments are also active in manufacturing and in real estate development. Government ownership is often decentralized along line ministries with an inherent conflict of interest between the ministry's ownership and its regulatory responsibility,¹¹² which can add to the suboptimal use of public resources. Governance of public commercial assets in the region is further constrained by a lack of transparency and adherence to international accounting standards.

While most developed economies have moved to a centralized management of assets, the best results have been achieved when assets have been consolidated inside an independent holding company, at arms-length from short-term political influence—as occurred with Temasek in Singapore (see Box II.16) and Solidium in Finland.

Once an asset is inside a holding company and subject to proper accounting standards, a comprehensive business plan will help put it to its most productive use and make clear the opportunity cost of using the asset in a sub-optimal way.

Implementing a hands-on active asset management approach will allow an economy to commercialize, optimize, and rationalize its commercial portfolio to the benefit of society. Commercialization of public assets requires that a comprehensive business plan reviews all assets, including real estate, that are unused, used by third parties, or directly used in the provision of public services, but that can either be reallocated or used to generate ancillary income.

¹¹² OECD (2019).

Box II.16. Temasek: The iconic state holding company

Temasek was established in 1974 as a separate holding company that was an active investor and shareholder in commercial enterprises and real estate to enable the government to maximize long-term shareholder value. Temasek consolidated all of the commercial assets owned by the government: existing holding companies and state-owned enterprises; previously existing monopolies and utilities that had recently incorporated and still resided within the respective ministries; and some real estate.

Temasek was used to separate the regulatory and policymaking functions of government from its role as a shareholder of commercial entities.

Since its inception, total shareholder return, measured in Singapore dollars, has averaged 15 percent per year. According to the 2019 Temasek Review.

Many of Temasek's holdings are now world-leading companies within their sector such as the telecom operator Singtel, the largest company by market capitalization on the Singapore stock exchange; DBS Bank, the largest in Southeast Asia; and PSA International, one of the largest port operators in the world.

Other well-known brands within Temasek include Singapore Airlines and ST Engineering, one of Asia's largest defense and engineering groups, as well as CapitalLand, one of Asia's largest real estate companies.

Temasek's political insulation is reinforced by professional boards and a risk management system that puts responsibility and accountability solidly with the board of each holding. The board of Temasek, as well as those of its holdings, consists of independent non-executive directors recruited on merit. Almost half of both management and staff are non-Singaporeans. Transparency and clear objective are also strengthened by the credit rating.

Optimization requires economies of scale be achieved across the entire portfolio, which includes rationalization—or sales of mature assets to generate funds to reinvest in higher-yielding assets.

Monies generated from rationalization activities should be first made available as a source of funding for the achievement of the business plan and then other investments such as infrastructure and housing. Alternatively, the yield could be used for economic development in other areas of benefit to society, such as schools, housing or hospitals.

▸ National wealth funds enable a shift in state assets toward infrastructure

A national wealth fund (NWF) acting as a holding company for public commercial assets offers a politically palatable way to shift state assets towards infrastructure in a way that could achieve three goals: increasing funding of infrastructure, putting infrastructure decisions on a sounder economic footing, and reducing government's direct and politically motivated access to those assets.

NWFs can help governments manage projects and encourage FDI by providing a window to international best practices and hands-on experience and management.

SWFs are in a financial position to invest in large infrastructure projects, but their expertise is financial rather than structural and operational. An important question is whether they have the competence that successful infrastructure

investments require. National infrastructure investment can be boosted and managed better by letting an NWF shift or sell state assets in other commercial holdings and invest in infrastructure consortia in their own country. In doing so, three measures that reinforce each other are important.

First, an NWF that invests in infrastructure should solely focus on profitability. Its job is to manage the value of operational assets, ensure economic soundness, and try to find structural deals that increase profitability. For example, many roads and railroad investments can become profitable if the increase in land value around these investments is internalized. An NWF is in a position to buy land surrounding an investment, making it profitable, or the NWF may already own the land through its other holdings.

Using an NWF to shift public assets toward infrastructure is also politically beneficial. Governments often keep state enterprises merely because there is no strong political belief in privatization. But a somewhat independent NWF that can sell excess real estate or non-essential SOEs and reinvest the proceeds in a profitable infrastructure would not be seen as relinquishing net wealth to the private sector, but merely shifting wealth within its portfolio.

Second, infrastructure projects that are not commercially profitable, but have a positive net social value, should be paid for by state or local governments in the form of “payments for use”. For example, a consortium owned by the NWF alone or together with private owners may make a contract with the state or a local government in which the consortium builds a road and the state commits to pay an annual usage fee that can vary depending on road accessibility and other quality parameters. This is already a common model in many public–private partnership (PPP) projects. For example, governments pay a PPP consortium annually for provision of a road or railroad often in relation to the quality the PPP achieves. That focuses governments on the value of a service to the consumer, rather than entangling them in difficult investment decisions that also offer temptations for corruption.

Third, an independent institute should continually evaluate the social profitability of infrastructure services that governments purchase. The evaluation should use internationally accepted tools to determine how to factor in environmental and social values. While the recommendations of such an independent institute probably wouldn't be binding, they would make the economic rationale for various projects more transparent and impose a political cost on governments that invest in bridges to nowhere.

There are a number of examples of governments using consolidated public commercial real estate assets inside a holding company to properly develop portfolios—both by segment and by location. Geographically it is most common at the local government level—as when the City of Hamburg (Germany) expanded by developing its old urban harbor area into one of the most attractive residential and commercial areas of the city—complete with kindergartens, primary and secondary schools, universities, and a world-class concert hall. Also, in the 1990s, economic malaise and high unemployment impelled Copenhagen's leaders to get creative. A professionally managed public wealth fund consolidated the city's old harbor area and a former military garrison on the city's outskirts. Beyond transforming Copenhagen's harbor district into a highly desirable area, income from the fund helped the government pay for an extension of its transit system without dipping into tax revenues.

Segmental holding companies have such operating assets as airports, postal systems, highways, ports, and railways. They all have real estate assets that could generate substantial value if managed professionally in independent holding companies. For example, Hong Kong, aware of its fiscal limitations, set up MTR, which found a way to build a subway

and railway system the size of New York City's without using a single tax dollar. To do so MTR developed the real estate adjacent to its stations. London Continental Railways in the United Kingdom led the remarkable transformation of the abandoned area around King's Cross Station into a hub for both tech start-ups and tech giants, such as Facebook and Google. The site also attracted notable academic and cultural institutions and has hotels, residential, and recreational areas.

▸ Impact on the sovereign rating

Lastly, improved management of government assets may also have a positive impact on a country's sovereign credit rating, which affects its cost of borrowing. Clearly, the monetization of public assets generates receipts that can be used to pay down existing debt, to reduce the need for new borrowing or to build the government's financial buffers. A reduction in a government's debt load, or slowdown in its pace of accumulation, and an increase in government financial assets directly improve the key metrics that the three global rating agencies use in their sovereign rating models.

In addition to assisting sovereign credit ratings, more efficiently managed assets would contribute to a higher rate of real GDP growth, generate dividends or other cash flows for the government budget, and lower operating costs, all a major benefit to society.

The example of Singapore has demonstrated that governments can be run like a business, while still providing public needs such as housing. Using both sides of the balance sheet and building strong and efficient institutions allow the short-term pain of institutional innovation to ultimately lead to long-term gain for the entire country and renew the country's commitment to posterity. Dubai is an example of a MENA country in which the government has managed its real estate assets professionally and maximized its limited resources. Other MENA countries can look to Singapore and Dubai as examples of how to manage and develop the asset side of the balance sheet in a professional way—to the benefit of society as a whole.

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