Mr. Hazem El Beblawi

Advisor

Arab Monetary Fund

Political and National Governance Reforms

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Political and National Governance Reforms
By Dr. Hazim El Beblawi[1]

Introduction

Good governance has become a key, contemporary economic policy topic. Governance methods are obviously linked to the prevailing forms of political and economic systems. Political reform and economic reform occupy an important place in the current general discussion and debate.

From the outset, it is essential to emphasize that "reform" will differ in meaning depending on the era. The meaning of political or economic reform in an era in which slavery or feudalism prevails will necessarily differ from the meaning of “reform” in an era of nascent industrialization. Therefore, when we speak of "political and economic reform" in this paper, we are referring to the circumstances of the Arab world at the start of the 21st century, following the end of the Cold War and the triumph of a unipolar system amid globalization.

Having defined political reform and economic reform, we may ask, are the two types of reform linked in some way and interdependent? Or can one exist independent of the other? This discussion will examine good governance and the political and economic reforms needed.

The Contemporary International Environment

Talk of reform is not new. As mentioned above, what is suited to one period may not necessarily be suited to other periods. Each period has its own circumstances and requirements. This discussion concerns a defined period of human history in a defined geographical region, the Arab region. What is meant by "reform" within these parameters? Before we answer this question, it may be useful to recall the most important features of the current period and discuss how these features affect concepts of "reform." In this regard, there are three key considerations. The first is the end of the Cold War and the emergence of the unipolar system. The second is the expansion of globalization and the contraction of distances and time between countries. The third is the relatively light weight of the Arab countries and the frailty of their economic and military power vis-à-vis the rest of the world.

Regarding the first consideration (the end of the Cold War and the emergence of a unipolar system), for close to 50 years following the end of WWII, the world knew a bipolar system. The world was divided into two camps. One was capitalist, centered in the West and under US leadership. The other was socialist, centered in the East and under Soviet leadership. Each bloc had its followers and adherents among countries and political organizations

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[1] [Former Secretary-General of the Economic and Social Committee for West Asia; advisor to the Arab Monetary Fund]

worldwide. The capitalist camp generally adopted a market economy system, democracy, and political pluralism. The socialist camp moved toward centralized planning. Under socialism, autocratic rule by a single party generally emerged as the predominant pattern. Differences existed among the countries belonging to each group, reflecting each country's particular circumstances. However, the general East-West division and the political trends in each camp persisted. Each camp's achievements regarding economic efficiency, individual fairness, and respect for individuals notwithstanding, the socialist system declined and dissolved in the last decade of the 20th century, ending in the collapse of socialism. Moreover, the Soviet Union itself dissolved, clearing the stage for a single system dominated by one pole, the United States. With the fall of the Soviet Union and collapse of socialism, socialist regimes lost material support from the socialist bloc. They also saw a decline in the credibility of centralized socialist systems with respect to their ability to achieve economic efficiency or respect for individual rights and freedoms. Most people came to believe that the socialist regimes were economic and political failures. Thus, the collapse of the Soviet Union led to a decline in the credibility of socialist regimes and autocratic rule. Regardless of the achievements accomplished under such regimes, albeit at enormous human costs, the collapse of the socialist bloc at the end of the 20th century conferred on socialism a verdict of failure. The preceding concerns the emergence of the unipolar world order and its relationship to political and economic systems.

Regarding globalization, while the Western and Eastern blocs were engaged in conflict, a latent technological revolution was in the making, especially in information and communications. The socialist bloc collapsed as globalization appeared, with its retreat of borders and shrinking of distances. Information now moves unimpeded between countries in seconds as a result of the information revolution. However, information is not limited to the transmission of ideas and news. The information revolution quickly became a “financial revolution." Money and financial assets move in the blink of an eye between countries. At approximately the same time, in late 1994, an agreement was signed to establish the World Trade Organization, which called for eliminating or easing restrictions and barriers on trade in goods and services. In view of US dominance in the new world order, US policy began to push toward greater global economic aggregation. Technological developments in information and communications, institutional changes (e.g., the WTO agreement), and ideological considerations concerning US dominance caused globalization trends to become preeminent. Amid these developments, the principle of national sovereignty retreated, and political boundaries became less important. Thus, considerations of technology, institutionalism, and ideology have converged to give dominance to democracy and the market model among political and economic systems.

The attached table shows general data on the Arab economies and other economies, particularly the extent of the frailty of the aggregate Arab economy.

Domestic Product, Foreign Trade, and Population (2000-2005)

	2000	2001	2002	2003	2004	2005
GDP	Millions of dollars					
World	31,63,514	31,461,473	32,728,606	36,757,732	41,253,156	44,433,002
Arab countries' total	671,201	651,836	667,610	746,026	874,444	1,052,282
Arab oil countries*	450,494	438,288	447,879	520,189	624,117	776,842
	Percentage					
Ratio of Arab countries to world	2.12%	2.07%	2.04%	2.03%	2.12%	2.37%
Ratio of Arab oil countries to total Arab countries	67.12%	67.24%	67.09%	69.73%	71.37%	73.82%
Exports	Millions of dollars					
World	6,384,970	6,140,400	6,428,600	7,465,400	9,067,400	10,196,700
Arab countries' total	263,131	237,894	247,072	307,634	407,674	558,238
Arab oil countries	211,241	190,768	196,669	254,793	339,582	472,294
	Percentage					
Ratio of Arab countries to world	4.12%	3.87%	3.84%	4.12%	4.50%	5.47%
Ratio of Arab oil countries to total Arab countries	80.28%	80.19%	79.60%	82.82%	83.30%	84.60%
Imports	Millions of dollars					
World	6,595,610	6,392,300	6,569,500	7,648,600	9,331,000	10,606,000
Arab countries' total	157,329	166,954	175,654	198,440	257,173	310,985
Arab oil countries	89,018	97,309	105,796	123,986	157,741	188,456
	Percentage					
Ratio of Arab countries to world	2.39%	2.61%	2.67%	2.59%	2.76%	2.93%
Ratio of Arab oil countries to total Arab countries	56.58%	52.28%	60.23%	62.48%	61.34%	60.60%
Total trade	Millions of dollars					
World	12,980,580	12,532,700	12,998,100	15,114,000	18,398,400	20,802,700
Arab countries' total	420,460	404,848	422,726	506,074	664,847	869,223
Arab oil countries	300,259	288,077	302,465	378,779	497,323	660,750
	Percentage					
Ratio of Arab countries to world	3.24%	3.23%	3.25%	3.35%	3.61%	4.18%
Ratio of Arab oil countries to total Arab countries	71.41%	71.16%	71.55%	74.85%	74.80%	76.02%
Population (millions of persons)						
Total of Arab countries	278	285	291	297	304	310
Total of Arab oil countries	66	67	69	70	72	74
	Percentage					
Ratio of Arab oil countries to total Arab countries	23.74%	23.51%	23.71%	23.5%	23.68%	23.7%

* Including Saudi Arabia, Kuwait, the UAE, Bahrain, Qatar, Oman, Algeria, and Libya.

The question is: How do these general considerations of the contemporary global environment affect the extent of countries' freedom to choose their political and economic systems, especially small countries with little economic weight and limited military power, such as the Arab countries?

The Meaning of Political Reform and Economic Reform

In view of the preceding on the general conditions of the contemporary environment, it seems that there is a general consensus that "economic reform" means adopting some form of democracy and political pluralism and eliminating manifestations of autocratic rule. "Economic reform" means the trend toward adoption of a market economy. Both democracy and a market economy are the modes most compatible with the circumstances of the contemporary world, namely domination by a single pole, the preeminence of globalization trends, the international balance of powers, and the economic and political circumstances of the Arab countries.

The combination of democracy and a market economy, which generally represents liberal thinking, entails many benefits but may be met with several reservations. Nonetheless, it can be said that in the current circumstances of most of the Arab countries, this model represents the most suitable reform orientation. On the one hand, most Arab countries have in the past known predominantly centralized, autocratic, and occasionally authoritarian political regimes. In addition, the state has been the primary player in managing and channeling economic resources. The results have generally been disappointing. Hence, it can be said that authoritarian regimes and growing government intervention in the economy have lost much of their credibility among the Arab peoples in view of the poor results achieved. With the decline in popular support for such systems, there have been growing domestic demands in the Arab countries for political and economic reform involving a change in the existing model.

However, the choice in this matter is not prompted solely by domestic pressures for change in most of the Arab countries. International conditions are also pressuring in the same direction. As stated above, since the end of the Cold War, a unipolar system has prevailed in the world. This system advocates adoption of liberalism in the manner mentioned above. This has been reflected in the international economic order. The WTO advocates and supervises free trade. The IMF and the World Bank advocate liberal economic policies that favor the evolution of a market economy. At the same time, international financial markets and large multinational corporations, which control most international industrial production, are pushing in the same direction. On the political side, we find that most UN organizations advocate respect for individual rights and freedoms. International media organizations, including newspapers and satellite stations, also push for defense of political freedoms with the support of many civil society organizations. Moreover, the major countries, primarily the United States, intervene to promote political freedoms. In the face of these external pressures, the Arab countries seem to be politically and economically weak relative to the rest of the world. The Arab countries in the aggregate are not equivalent to China, India, or even Brazil. The latter countries are major nations, more like continents with large populations. They have achieved varying degrees of notable economic success. They thus enjoy greater freedom of choice regarding their political and economic systems. Two of these countries, China and India, possess nuclear arsenals, and Brazil may be on the way to possessing its own nuclear arsenal. The Arab countries, given their small size and economic and political weakness, are less able to resist globalization trends. Therefore, it is no surprise that such countries as China, India, and Brazil possess greater freedom in choosing their economic and political systems. These three countries, despite their independence, are generally moving toward adopting the aforesaid international trends in political and economic systems. However, they do exercise their own discretion in deciding the dose and timing of change. China is moving more toward economic freedom and the adoption of market mechanisms but less toward political freedom. India, which has never abandoned its democratic political traditions, is now heading toward greater economic liberalization. Finally, Brazil is attempting to graft market economics based on a clear social tendency to protect the poor and marginalized while respecting the political rules of democracy.

The Arab countries do not possess the same freedom to maneuver. They generally accept economic reform and the trend toward a market economy. However, they seem more hesitant about accepting political reform, particularly as it entails changes in the ruling elites or their method of operation. Such hesitancy and procrastination are frequently justified by saying that economic reform requires stability, and that the hastening of political change could threaten stability and thus undermine the foundations of economic reform. For the Arab countries, the matter is not so much rejection of the principle of political reform per se as it is the selection of the appropriate timing in a clear sequence, where economic reform comes first, followed by political reform. The success of the Chinese experience is frequently cited in this regard.

Democracy and a Market Economy

The relationship between political democracy and a market economy has provoked much debate. Are the two linked and mutually supportive of each other as stressed by liberal thinking, or are they independent, such that one can exist without the other?

History is both clear and ambiguous on this question. The historical record clearly shows that democracy, political pluralism, and respect for individual rights and freedoms have existed only in tandem with a market economy. In centralized economies in which the state controls economic resources in the name of centralized planning, etc., governance has always been autocratic and centralized with no scope for political freedoms, pluralism, or the rotation of power. This has not precluded labeling systems of governance in such countries as popular or centralized democracies. None of these systems, however, can tolerate democracy in its customary sense except in name. The historical experience thus demonstrates a connection between a market economy and democracy. A market economy appears to be a condition for the existence of a political democracy.

However, is the converse also true? Is democracy a condition for the existence of a market economy? The historical experience does not provide a definitive answer to this question.

The Western industrial countries throughout most of Europe have adopted democratic systems with a clear social hue. However, there are other historical experiences in which a market economy is combined with a political dictatorship. The fascist and Nazi regimes were established and persisted in Europe amid the retention of a market economy in general. This is also true of most of the military dictatorships in Latin America throughout most of the 20th century. Even China at present is moving increasingly toward adopting market mechanisms while its single party, the Communist Party, continues to govern in the framework of severe restrictions on political and individual freedoms.

History does not help us provide a definitive answer regarding the extent to which a political democracy is needed to ensure the success of a market economy. Can a market economy succeed to the same extent regardless of whether the political system is democratic or dictatorial? We believe that although the historical experience demonstrates that a democratic system is not a condition for the existence and survival of a market economy, the success and florescence of good governance in a market economy depends on the existence of a series of features that are more compatible with democracy. Democracy may not be essential for the existence of a market economy. However, democracy is more compatible with the nature of a market economy. Democracy facilitates greater efficiency in a market economy. Hence, we must examine more closely the meaning and operation of the "market economy," which can be easily misunderstood.

Main Features of a Market Economy

A market economy is not merely buying and selling or even the existence of supply and demand. All economies without exception involve buying and selling, hence a type of supply and demand. Another misconception is that a market economy means the government's relinquishment of any economic role, i.e., the government lets matters take their normal course—“laissez-nous faire, laissez-nous passer.” The truth is that this famous expression was not uttered by a famous theoretical economist, but rather by a French merchant in the period of Louis XIV. The minister of finance at the time, Colbert, asked members of the French chamber of commerce, "How may the government of his highness the King help you?” One of the merchants, named Legendre, answered, “Laissez-nous faire.” Hence the aforesaid expression, which has gained wide fame because it encapsulates the essence of the market economy. In fact, a market economy presumes a primary role for both the government and individuals. The government is the regulator and supervisor of the rules of the game. It establishes and enforces rules of economic behavior. The government also provides general needs which the market cannot provide or cannot provide optimally. Thus, the government is a basic player in a market economy. However, it is not the only player, as is the case in centralized economies. While individuals and private enterprises make the most important daily economic decisions in a market economy, observers often forget the importance of the government's role in a market economy.

The market economy, in its proper sense, emerged only with the appearance of the industrial revolution. The industrial revolution was linked to the emergence of the market economy in its modern sense and the establishment of the modern state. Both the modern state and market economy stem from the industrial revolution. A market economy relies on the decentralized management of economic resources. Economic decisions are left to the discretion of individuals, albeit in the framework of government supervision, which provides for conditions and circumstances favorable to the market's performance of its role.

We should also remember that the market economy was not invented by a thinker or philosopher. Rather, it emerged as a result of historical evolution based on trial and error. It is still in the process of evolving as it adapts to new events. It is therefore not strange to find different market systems in different countries. Each system emerged and evolved based on the historical circumstances of each country. The market economy is not something that can be cloned. Rather, in each country, it assumes a form that is suited to the country and consistent with the country's history. Yet, there are some general features shared by all market economies. They include the following:

- A market system is based essentially on confidence in the ability of individuals to make decisions without a trusteeship. Therefore, the market system is based on recognition of the individual's legal freedom. The individual is capable of choosing the activity that he desires without compulsion. The individual is free to channel his intellectual and physical energies into the areas which he desires. Therefore, the market system is essentially incompatible with systems that are based on slavery, forced labor, or servitude. However, the market system does not conflict with resort by the government in exceptional, compelling circumstances—e.g., wartime or natural disasters—to the restriction of freedom of action. It is understood that such measures are temporary and are issued under liberal laws promulgated by democratic institutions that respect equality and individual rights.

- It does not suffice to recognize only personal freedoms. It is also necessary to recognize the rights of individuals to economic resources. This is known as property rights. This concept is not limited to property rights in the narrow sense. Rather, it comprehends all other real rights, including personal rights, freedom to enter into contracts, and respect for obligations resulting from contracts and pledges. The upshot is that there can be no market system without a clear, effective legal system governing rights and obligations. The effectiveness of the legal system requires a judicial system and a just, competent, unencumbered executive apparatus to ensure respect for the law and the upholding of obligations. No less important than the law is a guarantee that the law will be enforced. Needless to say, the existence of such a legal system and its appurtenances has the effect of boosting the volume of economic transactions and trade.

- The market is a decentralized economic management organization. This implies a multiplicity of economic units, including producers and consumers. No such unit, alone or jointly with another, may "control" market conditions. A monopoly is a type of centralized control that is incompatible with the concept of a decentralized market. Of course, a reasonable degree of competition is necessary.

- Trade remains limited and complicated without a sound monetary system in the economy. Money appeared as a result of trading requirements. However, the existence of money expanded trade considerably. It is therefore difficult to speak of a market system in the absence of money and an efficient monetary system, i.e., money whose value is reasonably stable. Money's role is not limited to being a means of exchange. Another no less important function of money is that it is the primary provider of information on the value of goods and services in society. By providing a measure of value, money provides a key indicator of costs and thus guides economic decision-making. Without it, market transactions would be bereft of a compass for determining relative values and costs. Therefore, stable value of money is an essential prerequisite for a successful market system and sound economic decisions.

- A market system will not succeed without a number of intermediaries to facilitate buying and selling transactions. If money is a medium of exchange, the intermediaries that mediate between final consumers and producers are useful to all parties. The specialized merchant, real estate broker, and other intermediaries have helped reduce the hardships of buyers and sellers in their search for a suitable transactor. However, intermediaries have also increased competition. More importantly, they help consolidate prices in the market. Selling and buying transactions are not separate, private transactions between the buyer and seller. Rather, they occur repeatedly and are well known, which has facilitated the emergence of known, stable prices for each good or service.

- The market deals not only with goods and services in the present, but also in the future. A producer may wish to increase his production to meet growing demand. He therefore desires investment. Another individual may see that the time is not right to enter into a new enterprise. He prefers to hold onto his savings until a later time. Or a person may not be able to invest at all and must be content to be a saver. What does he do? There must be financial markets that help savers and investors meet their needs. These financial markets depend on financial instruments recognized by law (commercial paper and financial securities) that enjoy legal protection and a reasonable measure of negotiability. Also needed are financial institutions that specialize in securities transactions, including banks, insurance companies, and exchanges that deal in securities and contracts.

- From the preceding, it becomes clear that trade in a market system is not limited to the real aspect of goods and services. It also involves a financial aspect, whether the prices paid in exchanges, the future obligations entailed by exchanges, the transacting of resources in the form of financial assets (stocks), short-term loans (commercial paper), long-term loans (bonds), or even options or future rights. Financial transactions involving different financial assets and currencies are sometimes more important than real transactions in goods and services. Thus, financial transactions are a dimension of real transactions. Consequently, the market's success and stability depend on a sound financial system. Such a system requires strong institutions with sound factors (capital and management), an unambiguous legal system that establishes limits and standards for the activity of such factors, and supervisory authorities. Thus, the success of a market system depends on the existence of a sound banking system, diverse financial institutions, effective supervision, and a rational monetary policy.

- The market system is essentially based on trade. It ultimately requires the comparison of values, hence information on values. Prices reflect supply and demand and provide information on buying and selling trends. The availability of information on different segments of the economy facilitates greater rationality in individual decision-making. Therefore, the market's efficiency increases as a function of any increase in the information available on different aspects of economic activity. Information should be available to everyone in a way that provides for equality and fairness. In this way, some individuals will not enjoy advantages as a result of knowing information not available to others. They will thus not be able to realize profits or avoid losses based merely on such information. Likewise, when making decisions that affect economic activity, it is essential to exclude personal interests, as such interests may conflict with the public interest. Hence, a successful market system requires maximum transparency and the prohibition of conflicts of interest and of benefit from unpublished information to further personal interests. It also requires efforts to protect consumers who lack complete information on the economic positions of the various enterprises.

The State and the Market Economy

A market economy rests on the basic assumption that an individual's pursuit of his personal interests will lead, not necessarily with the individual's intent, to the achievement of the public good. This is Adam Smith's basic "invisible hand" argument. Is this assumption valid? Is it always valid, or is it invalid in certain situations?

The market is not suited to satisfying every need. There are needs, some of them basic, which, because of their nature, cannot be supplied through the market. No society can survive without services that defend against outside attacks, or without achieving security and stability vis-à-vis chaos or disruptions or without guaranteeing the just treatment of individuals and respect for their rights. No society can evolve without a number of primary political, social, and economic institutions as well as legislative authorities, administrative supervisory agencies, and agencies responsible for establishing and maintaining public projects (roads, bridges, ports, and airports). These and other types of goods and services are essential for every society. The "market system" is by its nature incapable of providing them. Therefore, all authors, chief among whom is Adam Smith, agree that such goods and services should be defined as "public goods." They cannot be provided through the market, and the state must provide them.

The preceding demonstrates that the "market economy" and reliance on decisions made by individuals, while representing the main mechanism of economic management according to liberal thought, are subject to two basic constraints that cannot be disregarded:

- In some cases, the "market system" fails completely or partially to provide some of society's basic needs. In such cases, the state must intervene in one form or another to provide such needs in appropriate circumstances. Examples of such cases concern public goods and externalities of major importance compared to the benefits and costs redounding to the concerned economic parties.

- In all cases, even when the "market system" is suited to managing economic resources and satisfying needs, the state must be responsible for supervising the market's performance and preventing the market from the deviating from the market rules. The state establishes the market's rules and operating method. It also establishes the institutions and policies needed for the market to play its role. Market transactors, including individuals and enterprises, transact according to the "rules of the game." The state establishes and continually updates these rules.

In view of the preceding, some economists, perhaps the most famous being Musgrave, have attempted to define three functions of the state in economic life:

- Economic stabilization.
- Resource allocation.
- Income and wealth distribution.

We will generally make use of this division to define the state's roles. We will begin with the first function, which concerns the state's sovereign role. In this regard, Musgrave had in mind in particular the state's role in formulating economic policies to promote the economy and cope with the periodic imbalances of recession, unemployment, or inflation faced by industrial countries from the international crises of the 1930s to the last 25 years of the 20^{th} century. This led to the appearance of the economic ideas of the well-known British economist Keynes regarding the necessity of state intervention in economic life to achieve stability. In fact, the state's role in this regard is much broader than the mere formulation of policies favoring economic stability. The state must establish the necessary institutional framework for the efficient operation of the market system. It must also implement policies that ensure continued stability and economic growth. The state's basic economic role is to regulate economic activity by establishing appropriate legal regulations, establishing the necessary institutions, and adopting policies suited to the smooth operation of the economic system. The state also enforces the rules and regulations—it polices the economic system to ensure respect for laws and policies. The state must ensure stable macroeconomic quantities. It must prevent wasteful increases in the government's budget deficit or the irresponsible expansion of monetary spending, which threatens price stability. It must also provide for reasonable exchange-rated flexibility among the different currencies to ensure the most realistic exchange rates, as is well known in stabilization policies on macroeconomic quantities. The state must also provide favorable circumstances for economic freedom in terms of respect for property rights and contracts. The state must restrict monopolies and prevent illegal competition. It also guarantees the soundness and transparency of information and makes efforts to reduce transaction costs. Here, the state plays a sovereign role in establishing a legal framework and policies that enable engagement in economic activity.

The second function concerns the state's role in providing public goods in the area of security, defense, and justice as well as an appropriate physical infrastructure of roads, communications, ports, airports, and energy resources. The state also acts to expand educational opportunities and public health services. The environment and environmental protection have also become important state functions. The state also encourages scientific research of all types. The establishment of a social safety net and the combating of poverty and infectious diseases are also among the state's key responsibilities. The state's scope of responsibilities is broad and constantly evolving. Thus, the state is not limited to establishing rules and policies. It also provides direct services and public goods that the market cannot supply or cannot supply on favorable terms.

Finally, the state has a distribution function. The state adopts policies and measures to counter any extreme income and wealth discrepancy to achieve the just, fair distribution of income and wealth. This function provokes considerable debate, not so much over the principle of this function but rather its extent. The primary goal of economic systems is not wealth distribution, but rather wealth formation and growth. Therefore, distribution policies designed to achieve greater fairness should always avoid squandering the factors needed to build wealth and should avoid impairing future growth. Extreme wealth discrepancies threaten justice and equality and are often a curse for growth and progress. Greater equality is not always achieved at the expense of potential growth and progress. Rather, equality may be a condition for growth and progress. Hence, the state is responsible for ensuring fairness and equality. It intervenes to achieve greater equality, and it must certainly prevent glaring class differences in society. Taking into account the above-mentioned considerations, wealth and income redistribution measures and policies must be implemented within a liberal conceptual framework, i.e., with respect for the law and an emphasis on avoidance of infringement on individual freedoms. All of this must be effected in a framework of legality and dialogue through democratic methods.

The Basic Principles of Democracy and Good Governance

Following our review of the key features of the market economy, the question remains: To what extent is political reform needed for the good governance in a market economy? Historically, market economies have not always been linked to democracies. They have existed under regimes whose distance from democracy ranges from slight to great.

However, if nothing definite can be said in this regard, there are at least grounds to underscore that a democratic system provides the best conditions for good governance in a market economy. How is this the case? We have seen that the state plays a primary role in a "market economy." However, the question is, what type of state are we discussing? What type of state best harmonizes with the needs of a market economy? Is it a police state, an autocratic state, or a democratic state? This is the question. We believe that only a democratic state can provide the best conditions for the successful operation of a market economy and thus provide the elements of good governance.

A democratic system is based on a number of principles that ensure good governance of a market economy, the most important of which we treat below:

- **Rule of law**: Perhaps the most important characteristic of democratic systems is that they are based on the rule of law. The law is not merely an instrument in the hand of the ruler, which he imposes on his subjects. Rather, everyone is subject to the same law, including the ruler and the ruled. A democratic state is a state of law and regulations. It is not the state of individual or personnel rule. What we have in mind here is democratic liberal law. Such law must be promulgated according to the rules stipulated in the constitution, and it must be approved by the people's representatives. Otherwise, it will bear the seeds of infringement on individual rights and freedoms. Laws should be published and should not be retroactive save for exceptional cases that do not infringe on the legitimate rights and interests of individuals. Of course, the rule of law also requires a sound, fair, speedy, unencumbered judicial system and an executive authority that can enforce the judiciary's judgments fairly. We will see that the rule of law is not only a requirement for sound democratic life, but also essential for successful economic activity in a market economy.

- **Information and transparency**: Economic decision-making involves the calculation or comparison of costs and benefits, and the assessment of opportunities and possible risks. All decisions require data and information on prevailing conditions. This applies equally to a decision made by the government authorities, an individual, or an enterprise. In a market economy, most economic decisions are made at the individual level. The soundness of such decisions depends on the economic information available to the decision-maker. Most if not all autocratic and non-democratic countries are familiar with the suppression of information in the name of national security or supreme interests. They are also no strangers to speculation, exaggeration, and sometimes lies. Information under such regimes does not concern facts. Rather, it is an instrument of policy enlisted for multiple purposes that are generally concealed from the public. The transparency of information and data is inherent in democratic systems. Most democratic countries are committed to publicizing accurate information on various aspects of their activities. Moreover, in many cases, the law requires them to disclose such information. Normally, these countries observe international data standards and definitions, which facilitates comparisons. Thus, the transparency required by democratic systems provides for the availability of the data and information needed for decision-making. Most democratic countries do not restrict themselves to merely issuing public information. They also promulgate laws requiring individuals and enterprises to issue accurate financial statements on their economic activities. The transparency and openness of democratic systems facilitate economic decision-making in a market economy.

- **Credibility and accountability**: Being based on the rule of law, democratic systems are also based on institutions, which are far removed from the notion of personal or individual rule. Institutions provide a large measure of stability in public policies and attitudes in contrast to the situation in autocratic governments. The latter experience sharp fluctuations in public attitudes whenever the ruler is replaced. Stable policies and attitudes provide for greater credibility and confidence on the part of individuals and enterprises. Some non-democratic regimes may know stability and continuity in the person of the ruler at times. This usually reflects stagnation more so than stability. Stability, not stagnation, is needed. Stability allows for ongoing development and change in a natural, anticipated way, without surprises. Non-democratic regimes include within their folds conflicting possibilities for both stagnation and surprise. Democratic systems offer a reasonable measure of stability. Such stability permits change and orderly, anticipated evolution, consistent with the requirements of general conditions. These matters help increase credibility in democratic systems.

  Accountability and supervision further enable democratic systems to evolve in an orderly fashion. Democratic systems are based on the rotation of power through elections. The rotation of power opens the field for a discussion of policies, achievements, and failures in the transparent atmosphere that exists. Any deviation, error, or even misfortune is subject to disclosure, hence discussion and accountability. Thus, the rotation of power makes it possible to discontinue erroneous or damaging policies or practices and to correct matters. It also provides an opportunity to inject new blood and enhance adaptability. This increases the credibility of the economic system and provides an incentive for individuals and enterprises to undertake new initiatives.

Political Reform and the Investment Climate

Above we treat the key basic principles of democratic systems that facilitate the florescence of a market economy and good governance therein. It should be stressed that a market economy requires a general climate that is favorable for investment. I have treated this subject elsewhere. I will only say here that the investment climate is in serious need of political reform.

The investment climate concerns multiple aspects, including infrastructure, legal systems, political conditions, institutions, and policies. It is a complex, sophisticated concept. The elements of the investment climate may be favorable in one period but not in another period due to developments that overtake competing countries and regions. The investment climate is dynamic. It constantly evolves to keep pace with political, ideological, technological, and regulatory changes. Generally, "favorable investment climate" can be placed under two major headings: economic decision-making ability, which is linked to uncertainty; and factors that affect cost and return, which are linked to risks.

I. The investment climate, and a suitable environment for economic decisions: Economic life is a series of economic decisions made in response to new developments. Investment does not involve a single decision to invest or not to invest in a specific country. Rather, it is a commitment to transact with a specific economy over a time period that may evolve into years, decades, or longer. During this period, the investor must make many decisions to deal with various possibilities. An investor's decision to invest depends largely on the availability of infrastructure suited to enabling him to make rational economic decisions. The investor must decide on the product type, the development of product types and components, whether to expand production, the timing and geographical distribution of expansion, whether to enter into alliances with competitors, whether to cease production and liquidate the enterprise, etc.

Therefore, the first prerequisite for the entry of investors into any country is the availability of an acceptable, minimum capability to make economic decisions in the future to ensure the enterprise's soundness and to protect its interests. This depends on many factors, chief among which is political and security stability. If the political conditions are unstable, or security is lacking, doubts cloud the future. No investor can make a decision when he knows that his future will be threatened at any moment by a coup, revolution, chaos, or security unrest. Therefore, political and security stability are primary, essential prerequisites for any investment. As stated above, the absence of democratic systems produces a paradox damaging to economic activity, i.e., in non-democratic countries, there is always the possibility of sudden change when the leader is absent; however, conditions in the country remain stagnant and undeveloped as long as the ruler remains in power. Political corruption is linked to political stability. Political corruption normally leads to a lack of free, sound competition and ambiguity regarding the rules of the game. It comes impossible to make economic decisions without rules for transacting that are clear, publicized, and known.

However, the ability to make decisions does not depend solely on political and security stability. It also requires legal stability. Economic decisions ultimately concern legal actions to dispose of property, contracts with suppliers, or a contractual commitment to supply goods or undertake tasks. Thus, the existence of a clear, effective legal system is a basic requirement for the undertaking of economic activity, especially investment. In this regard, unambiguous laws on property and rights that recognize rights and regulate their boundaries and limits are indispensable for making any economic decision. Generally, economic decisions focus on the trading of property rights etc. among different parties. Ambiguous laws or a multiplicity of incompatible laws will impede any investor. Moreover, multiple, contradictory laws—i.e., regular, emergency, and sometimes martial laws—contradict the logic of the rule of law.

Legal stability goes beyond legal clarity to also include predictability regarding future legal conditions. If there are no general rules governing legal stability, such as recognition of the legality of private property or individual contracts, property becomes subject to sudden nationalization or expropriation without controls, which disrupts legal stability. Thus, legal stability assumes respect for legitimate expectations without exposing investors to surprise laws that overturn conditions and upset investors' economic calculations. In this context, legal stability intermeshes with political stability, because political stability prevents radical surprises in legal positions. However, legal stability requires more than unambiguous legal systems. Laws must also be effective and properly enforceable (law enforcement).

Monetary stability is no less important than political and legal stability. Economic decisions are ultimately decisions to purchase or sell monetary values, lend, and borrow in the present and future. Thus, decisions involve a comparison of cost and return, both of which are measured in money. If the value of the money is unstable, all economic decisions lose their foundation if not their soundness. Hence, the importance of monetary stability. No less important is financial stability. The investor must not be surprised by new taxes or tax hikes that go beyond his legitimate expectations. If political, legal, monetary, and financial stability are essential to create a sound environment for economic decision-making, no less important, as stated above, is the need for sound, regular financial data. An economic decision is ultimately the product of knowledge of the economic situation and possible developments. An economic decision can be reached only on the basis of published data on the different economic sectors.

It is difficult to make an economic decision without the elements mentioned above. However, the investment climate is also subject to circumstances in which economic decision-making is possible, but at a high cost.

II. Investment climate and production costs: In making a decision, the investor must weigh the costs against the return. To a large extent, the investor controls costs within his enterprise. He chooses the appropriate technology and best machinery and equipment needed for his production. He designs his enterprise so as to control production costs and to enhance his ability to increase distribution and diffusion. This is the investor's responsibility for his enterprise. However, the enterprise is not a self-contained entity. It depends on external factors. The investor faces other costs over which he has no control, costs which depend on the environment in which he operates. The enterprise obtains numerous services from its environment, such as electricity, water, communications, transportation, etc. The problem here is not only the availability of reasonable prices, but also the need for stable prices. In most cases, enterprises depend on each other and—increasingly—on outsourcing to provide many of their requirements. Countries differ as to the availability of such services. The enterprise also deals with government agencies concerned with taxes, customs, and supervision. Thus, production costs depend not only on the enterprise's efficiency, but also, to a large extent, on the environment in which the enterprise operates and on multiple external factors that can increase production costs.

First, there must be physical infrastructure (roads, ports, airports, communications, transportation, energy—electricity and gas—and water). Suitable human resources in the form of trained, capable manpower must be available. There must also be suitable labor laws that do not pose obstacles. In addition, it is important that there be training and qualification centers as well as professional organizations that provide competent, advanced technical consultations.

On the institutional side, there is a need for real, effective markets that can provide a reasonable measure of honest competition. There must be access to a reasonable flow of information regarding prices, commodities, commodity features, and possibilities for entry into and exit from economic activity without extreme impediments. There must also be intermediaries and brokers. An advanced financial market is extremely important in catalyzing investment. Finally, a financial market will not be disciplined in the absence of clear rules and capable, effective supervisory entities.

Cost elements beyond an enterprise's control are not limited to physical infrastructure, human resources, or institutions. The enterprise also bears many costs for conducting various transactions, particularly with government agencies. Transaction costs have become a key component of an enterprise's costs. An enterprise must conduct multiple transactions with government departments to obtain permits or licenses. It transacts daily with customs and tax departments and the ministries of labor and social security. It submits bids in various tenders. It has dealings with nationality departments to obtain entry and residency visas for its foreign personnel. In all these transaction, there is sometimes a lack of clarity regarding laws and occasionally a conflict between laws. Frequently there are delays and slowness. An enterprise may also face discrimination and corruption. Transaction costs are generally higher in countries lacking the rule of law and accountability due to the prevalence of corruption, party patronage, or other manifestations of corruption. By contrast, these matters are treated more seriously in an environment of transparency and accountability, i.e., an environment that is more democratic. All of this inevitably affects the extent to which good governance is achieved.

Conclusion

From the preceding, we may conclude that under contemporary conditions, political and economic reform in our region means adapting democratic systems and political pluralism on the one hand and a market economy on the other hand. Democracy is not a prerequisite for the existence of a market economy, but democracy enhances the efficiency of a market economy and improves the conditions for good governance under a market economy. Economic reform without parallel political reform does not provide the market with the best conditions for the performance of its role. The basic principles of democratic systems—the rule of law, transparency in financial statements, etc., credibility, and accountability—are as essential for a successful market economy as they are for the existence of a democracy. Finally, a sound, a stable democratic system generally provides for reasonable forms of political and security stability, which creates a reasonable investment climate.

The historical experience does not allow one to determine with certainty that a market economy can exist only in the environment of a sound of democratic system. Nonetheless, recent experience confirms that the absence of a sound democratic system can completely thwart good or rational governance in a market economy and result in the plunder of resources and the flight of wealth. In the early 1990s, the Soviet Union collapsed. Yeltsin took power. He expedited the Russian economy's shift to a capitalist system without the establishment of rules for a sound democratic political system. This resulted in the triumph of a new capitalist mafia in one of the largest known cases of plunder and theft in history. Therefore, the existence of a sound democratic system—which includes transparency, the rule of law, and accountability—is essential for the success of a market economy. It is even more essential in periods of a transition to a market economy. Democracy and the market economy draw on the same principles. Democracy helps a market economy improve its performance and vice versa. Democracy is virtually impossible if power over economic resources is concentrated in the hands of a central entity that has free reign over the people. Moreover, an economy in the absence of democracy and the rule of law may deviate, resulting in plunder and theft, as happened in Russia after the fall of the Soviet Union.