

In 1999, SigmaBleyzer initiated the International Private Capital Task Force (IPCTF) in Ukraine. Its objective was to benchmark transition economies to identify best practices in government policies that improve the investment climate and attract private capital. An Action Plan was developed and presented to the Ukrainian government, which identified the economic policy actions necessary to improve the investment and business climate in Ukraine, attract additional flows of private capital to the country; support economic growth, and improve the quality of life for their citizens. In 2001, this effort was expanded to all countries of the FSU, and IPCTF ratings for all 15 countries of the FSU were developed. They are available from SigmaBleyzer and The Bleyzer Foundation.

The Bleyzer Foundation was established in 2001 in order to promote the IPCTF framework and help countries implement the policies necessary to successfully complete transitions to market economy.

The Foundation's Managing Director is Mr. Victor Gekker, who is supported by a team of economists and business analysts. The Advisory Board of The Bleyzer Foundation is chaired by Dr. Edilberto Segura and provides advice and guidance to the activities of the Foundation.

# The Role of the International Private Sector in the Middle East

The Middle East has developed into a breeding ground for terrorism. Why? It is not because of extreme poverty, which is lower when compared to poverty in Central Africa and many regions in Asia. In fact, many of the countries in the Middle East that are currently large breeders of terrorists, such as Saudi Arabia, are among the richest countries in the world.

Some people have argued that undemocratic governments in the region must be blamed for terrorism, since their populations do not enjoy political opportunities. This has created many unhappy dissidents. This may explain part of the problem. But undemocratic governments exist in many other regions of the world, without creating the same fertile grounds for terrorism. Furthermore, terrorism can only be partly explained by the Israeli-Palestinian conflict outside the conflict areas.

We believe that the main reason for discontent and frustration in the region is the fact that income distribution in the region is quite uneven, with a very few extremely rich families enjoying the bulk of the region's wealth. The rest of the region's population is not suffering from absolute poverty. In fact, over the last two decades, the Middle East has seen significant increases in the well-being of its populations. But these income improvements have been less obvious than the improvements attained by the rich. Until two decades ago, these income inequalities were not apparent to most people in these countries, since information flows were limited. However, the lower income groups are now better able to recognize this growing income disparity with the rich, thanks to the communication revolution that has vastly improved the exchange of information. Consequently, with greater realization of wealth disparities, many groups of people are becoming more dissatisfied and frustrated. Therefore, despite the fact that the region enjoys relative prosperity, social tensions are high.

These social tensions coupled with general political instability in the region and religious fanaticism are frequently channeled by some wealthy, educated but power hungry individuals to instill hatred to Israel, United States of America and the Western way of life. This is actually an old trick of diverting the dissatisfaction and frustration of the masses to focus this destructive energy away from the source of the problem thus preserving the status-quo. The modern terror takes its root from this old despotic technique but is amplified dramatically by the technology, access and openness of the twenty first century.

Recent terrorist events have shown that developed countries cannot isolate themselves from these events. They will not be immune to the tensions affecting the region. Therefore, helping these countries to overcome their current situation should be the highest priority for the most advanced countries.

It is clear that solving the Israeli-Palestinian conflict will be a necessary condition to reduce discontent. But this will not be enough. The problem of acute income disparities urgently needs to be addressed. Either the status-quo or gradual improvements over time are no longer satisfactory options. Similarly, the simple transfer of wealth from the rich families to the rest of the population will not be a long lasting answer. It would just be a temporary solution that would make the population even more dependent on transfers and subsidies. What is needed is a concerted effort to develop alternative sources of wealth for the rest of the region's populations.

The governments of these countries should have a strong interest in fostering and accelerating "wealth creation" for their populations, or at least they can never openly deny their preparedness to do so. Developed countries should be more proactive in helping these countries address their problems and accelerate their creation of wealth.

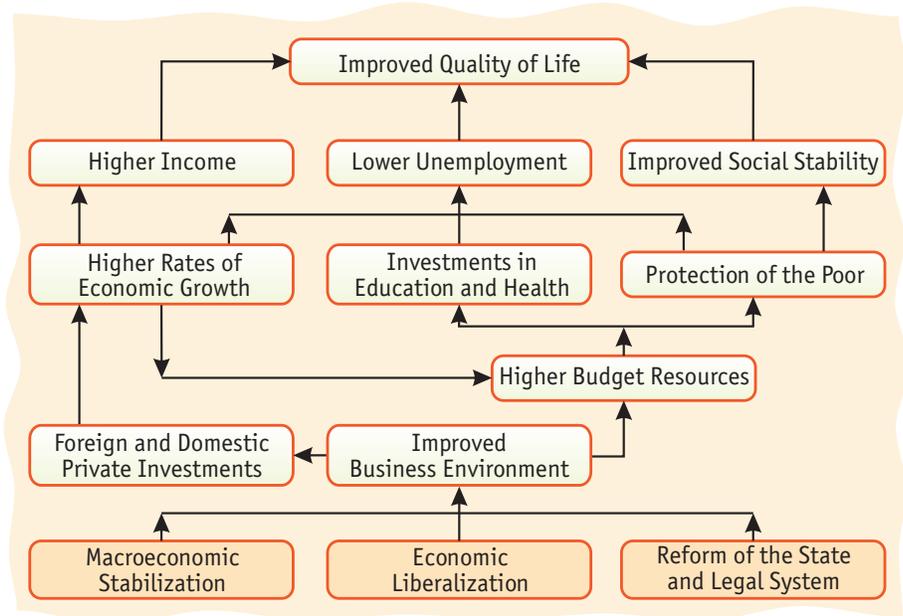
## **How to Create Wealth**

The international experience on wealth creation shows that an open and competitive market economy is the best system to create wealth in an expeditious and sustainable manner. An open market economy would give people the incentives to make a profit and generate wealth, while competition would "regulate" the market to avoid abuses of power. The creation of wealth is the only sustainable way to

improve the quality of life of populations. And the creation of wealth requires the implementation of economic reforms that will improve business environments, increase investments and foster economic growth at high rates.

The chart below shows the relationship between improvements in the quality of life, sustainable growth, investments and economic reforms.

**Wealth Creation Chart**



The chart shows that the quality of life will improve to the extent that salaries and incomes increase, the level of unemployment is reduced, and there is improved social stability. To achieve these results, a key factor is a high rate of sustainable economic growth. Higher rates of economic growth would generate higher fiscal budgets, which should enable the country to invest in health and education and to better protect the poor. High and sustainable economic growth, however, will require high levels of new private investments, both domestic and foreign. The level of investments will depend on the adequacy of the business environment, which can be summarized as the combination of three factors, as noted in the chart above: macroeconomic stability, economic liberalization and sound government and legal systems.

Unfortunately, most Middle East countries have inadequate business environments that dissuade, rather than stimulate investments. To change this situation, these countries would require a rapid and fundamental change in their economic policies. These policies would have to give emphasis to the creation of a favorable business environment that would be attractive to investors.

Through studies in a number of countries, The Bleyzer Foundation has developed a framework for the creation of a favorable business environment for domestic and international investments. It identifies nine key "investment drivers":

- (i) business liberalization policies to permit firms to operate freely by removing barriers to entry, barriers to operations and barriers to exit
- (ii) policies to create a stable and predictable legal environment with well-defined "rules of the game" for all businesses, without discrimination or preferential treatment and with capacity to enforce business contracts
- (iii) policies to develop sound corporate and public governance that would ensure ownership rights, protect small shareholders and avoid excesses of power by government agencies
- (iv) policies to liberalize foreign trade and international capital movements to facilitate the exports and imports of goods and the transfer of capital internationally
- (v) policies to create a healthy financial sector capable of meeting the financing needs of growing businesses
- (vi) actions to minimize corruption and protect businesses from abuse of power by government officials
- (vii) actions to minimize the effects of political uncertainties on business activities
- (viii) actions to improve the image of the country and promote and inform investors about business opportunities in the country
- (ix) policies to rationalize and eliminate distortions in investment incentives, by eliminating preferential targeted investment incentives to companies, regions or sectors

## Plans of Action to Accelerate Wealth Creation

The implementation of the above Bleyzer Foundation economic policy framework would vary among the various countries in the Middle East, since they do have fundamental differences: the oil-rich countries, Iraq, the non-oil rich countries, and the Palestinian zone.

But in all these countries, a fundamental principle should be established. This principle is that the international private sector should be engaged from the inception of this work, at the early development stages. In similar situations, past practice has been for official institutions (bilateral and multilateral) to develop the economic reform plans with the hope that the private sector will come later on. However, many of these programs missed the targets. The international private sector has just concentrated most foreign direct investments in a few countries. In fact, in the last couple of years, 65% of FDI has gone to 5 countries: China, Brazil, Mexico, Chile and Poland.

For a rapid "supply" response in the Middle East, it is necessary for the private sector to participate in the development of plans and strategies and participate in the entire process from the beginning. This will ensure that the right constraints for private sector investments are identified early on. Today, there are a growing number of international private investors who recognize that this is a more desirable route for everybody concerned.

## The Oil-Rich Countries

One of the problems of oil-producing countries is that the oil industry generates few employment opportunities. This tends to concentrate wealth in the hands of a few. A second problem in these oil-rich countries is that the easy availability of foreign exchange from oil tends to over-value their foreign exchange rate. This overvaluation makes other economic activities in the countries less competitive and therefore, less attractive to investors. This is a phenomenon called "Dutch Disease," which affected Holland when significant gas resources were initially developed and many industries went bankrupt. Given the low employment characteristic of the oil industry and an uncompetitive environment due to overvalued exchange rates, unemployment or "partial" employment in the rest of the economy tends to be high. Although many people in these countries do receive government

salaries, monetary transfers and subsidies, this high dependence on government resources creates discontent and resentment. It is therefore not surprising that many oil-rich countries are breeding grounds for terrorism, even for people that are relatively well-off.

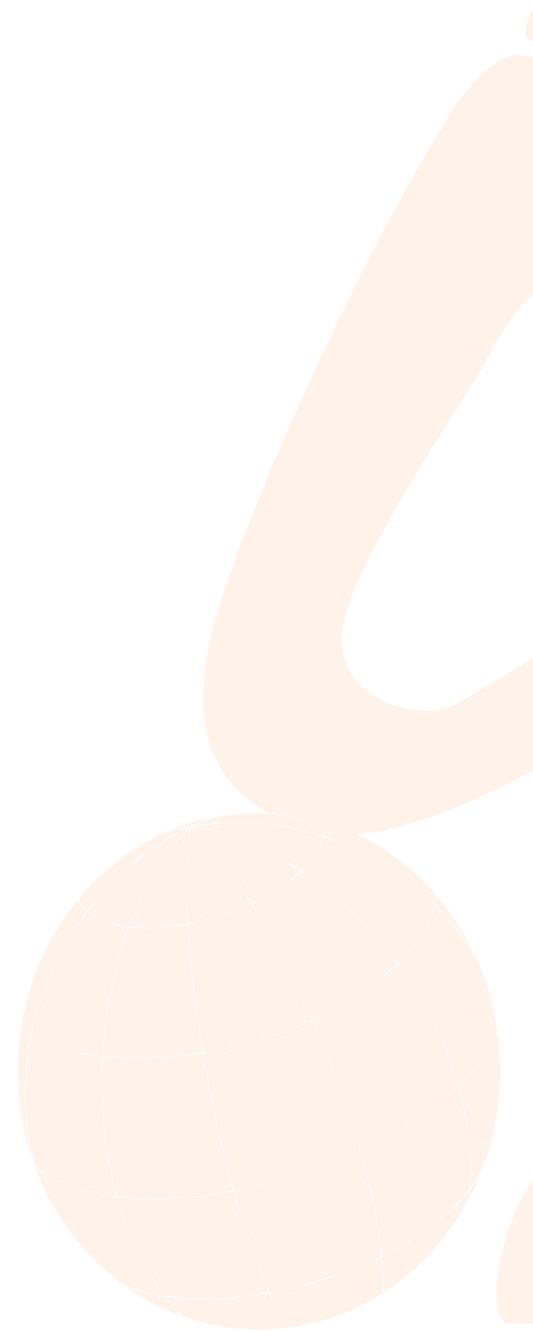
A priority of these countries should be to diversify their economies, in order to reduce oil dependence and create other employment possibilities. Given their substantial wealth, financing for economic diversification could be provided internally using oil resources. But this should not be a task carried out by local governments or domestic vested interests groups. In fact, experience in the region with projects undertaken by local government agencies has not been favorable. The best strategy would be to use oil revenues to form private equity funds and venture capital funds, but under the management of qualified international private investors. These funds could also be created as joint ventures with international private investors, under which foreign investors would take some of the risks. In any event, the international private investors would be able to bring financial know-how and experience in investing in economically viable projects.

But in order to significantly increase the success rate for these investments, it is essential that the countries implement The Bleyzer Foundation economic policy framework. Otherwise these investments would suffer from a lack of liberalization, poor legal environments, poor corporate governance and the other constraints typical of these countries.

Although these countries do not need significant amounts of international financing, they may also benefit from direct foreign investments, especially to receive new technologies, know-how and international management experience associated with FDI. In many countries, the main advantage of FDI has been the transfer of international know-how that these investments bring.

## **Iraq**

Although Iraq is an oil-rich country, it has additional problems arising from decades of mismanagement, corruption and isolation.



In Iraq, the Allied countries would be well advised to put together a team of international private sector business leaders who can act as a "steering committee" to supervise and monitor the execution of a quick but thorough review of the above policy framework in Iraq by private sector specialists. These specialists would also identify and develop the economic measures that should be taken to improve Iraq's business environment.

In the oil sector, priority should be given to improving transparency and predictability in order to encourage private international companies to get involved in the sector. Otherwise, the oil sector will continue to be plagued by the current high degree of corruption.

### **The Non-Oil Rich Countries**

In non-oil rich countries, The Bleyzer Initiative economic policy framework would be the key to accelerated economic development. These countries need to implement this policy framework in a very consistent and comprehensive manner. Experience in other countries shows that inconsistent and incomplete implementation of the economic policy framework does not yield positive outcomes.

### **The Palestinian Zone**

Given that this zone has one of the highest concentrations of people, the emphasis of the economic framework should be to develop labor-intensive industries, particularly micro, small and medium industries. In this zone, official international finance may need to provide the bulk of the requirements of the zone. But this assistance should not be provided as blind pools of money to be used by the local authorities. It should be provided in a way that would create private sector enterprises, even if they are micro, small or medium enterprises. This may require providing additional financing to specialized banks that make small loans to individuals based not only on their own creditworthiness, but based on joint and several guarantees of groups of borrowers from the same neighborhood.

Nevertheless, the implementation of the economic policy framework should also receive priority in order to boost the development of these activities.

## Conclusions

Properly implemented, the policies outlined in The Bleyzer Foundation economic policy framework should attract significant resources into the Middle East, diversifying their economies and providing sustainable and significant job opportunities for its people. This effort could be the most important contribution that the West could make to improve the quality of life of the people and neutralize those groups that want to promote terrorism. International Private Sector must play a much more active role not only in investing in selected attractive areas, but by actively advocating the business environment changes they expect to see in the countries of the Middle East to attract increased flows of FDI in all sectors of economy.