

BACKGROUND NOTE

Thematic Session 2: Strengthening Transparency and Good Governance¹

Governance consists of the written and unwritten rules by which governments exercise their authority, including their capacity to formulate and implement sound policies and preserve adherence to the rule of law. This note first lays out how transparency and good governance support economic activity, and provides an overview of how the Arab Countries in Transition (ACTs) fare today on widely accepted measures of transparency and governance. The note then identifies the key areas of reform that ACT governments may want to consider to support their economic transformations.

I. THE CHALLENGE

Transparency and good governance are good economics

Transparency and good governance enhance growth. A growing body of empirical research suggests that well-governed countries are more successful in creating investment, growth, and employment (Mauro, 1995; Svensson, 1998; Hall and Jones, 1999; Kaufman et al., 1999; Acemoglu, Johnson, and Robinson, 2001; Freund and Rijkers, 2012), and that transparency is an important prerequisite for good governance because it helps clarify rules and institutions (Ferraz and Finan, 2011; World Bank, 2004, Reinikka and Svensson, 2005; Deiniger and Mpuga, 2005; Besley and Burgess, 2002).²³ To an important extent, these effects are explained by reduced room for corruption and discretion as governments increase access to information and thereby make rules more predictable and those who create them more accountable.

Transparency improves the allocation of resources and strengthens trust. With improved access to information, individuals are better equipped to monitor events, evaluate options and manage risks (Akerlof, 1970; Stiglitz and Weiss, 1981; Stigler, 1980; Stigler, 1971; and Posner, 1981).

- In the public domain, information empowers citizens to monitor the quality of government services and the use of public resources. For example, evidence suggests that timely and regular

¹ This Note was written by Carolin Geginat with excellent research assistance by Shady Darrag, Paul Zimand, and Daniah Orkoubi. It benefitted from comments from Daniela Gressani, Bjorn Rother, Jean-Francois Dauphin, and Gaëlle Pierre. **This Note should not be reported as representing the views of the IMF.** The views expressed in this Note are those of the author and do not necessarily represent those of the IMF or IMF policy.

² While there is also some evidence that growth can promote governance, there is greater evidence of the reverse causality. Chong and Calderon (2000) even argue that there is mutual causality.

³ There are several channels through which the quality of governance affects countries' growth performance. First, poorly protected property rights and a lack of predictability in how policies and regulations are being implemented negatively affect investment in physical or financial capital and, by extension, growth. Good governance also supports trust between the public and the private sectors, which reduces transaction costs as firms will engage less in rent-seeking activities.

publication of school funding leads to parents monitoring more closely how schools manage their finances and ultimately reduces corruption (Reinikka and Svensson, 2005).

- In the private sector, information helps investors differentiate between more promising business opportunities and those that are less so; and it allows banks to distinguish between good and bad clients and, hence, helps direct resources to their best use.

Transparency and governance need strengthening across the ACTs

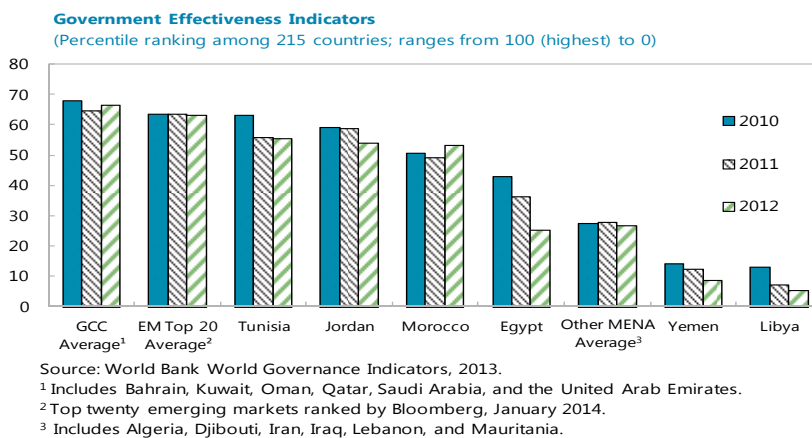
ACT governments fare poorly on global governance rankings. In addition, in several ACTs, the perception of government effectiveness—the reach and quality of public services, the professionalism and independence of the civil service, the quality of policy formulation and implementation, and the credibility of the government’s commitment to such policies—has declined between 2010 and 2012 (Figure 1).

In the Middle East and North Africa (MENA) region, transparency and good governance are a concern for resource allocation.

Corruption is a major concern, with a majority of firms in the MENA region reporting that they have experienced bribe payment requests—a much higher share than in any other region in the world (World Bank Enterprise Surveys).

In addition, officials are often perceived as being partial in changing or applying the law, for the benefit of a few well-connected firms, families, and institutions (World Bank, 2009).

Figure 1. Governance in the ACTs has weakened in recent years.



II. A POSSIBLE WAY FORWARD

Policymakers in the ACTs have many opportunities to strengthen transparency and good governance – and civil society to advocate for them – in the public and private sectors. Actions in these areas have clear economic benefits but most also pose difficult implementation challenges.

A. Strengthening trust in and service provision of the public sector

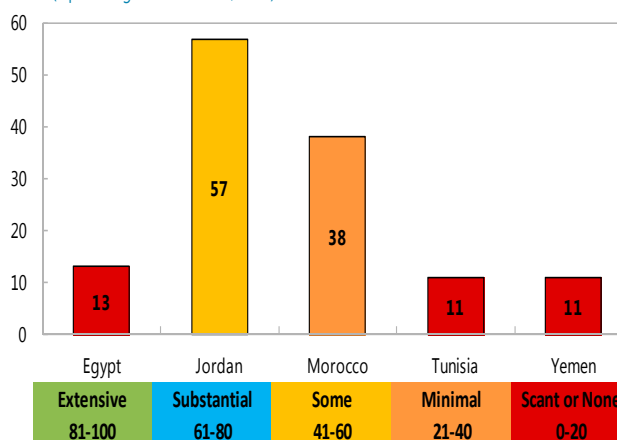
Improved access to budget information. Access to budget information can empower the public, audit institutions, and the media to hold governments accountable for the use of public resources

(Hameed, 2005; Dabla-Norris and others, 2010). This said, to date budgets in some ACTs rank among the least transparent in the world (Figure 2). Some countries have started to take encouraging steps towards greater budget transparency. Owing to the ‘Citizen’s Budget’ published since 2011, Morocco managed to double its score in the last Open Budget Survey; and Tunisia published its budget for the first time in the country’s history in December 2013.⁴ To further increase budget transparency, the ACTs could:

- Improve the timeliness of fiscal reporting and expand coverage;
- Include public corporations in public finance audits, as their debts are often implicitly or explicitly government-guaranteed;
- Ensure that at least a minimum set of budget documents are published in a regular and timely manner and that public hearings are held on budgets to solicit citizens’ views;
- Ensure that not only planned budgets but also measures of actual budget execution are published to support ex post expenditure controls;⁵ and
- Strengthen the effectiveness of fiscal oversight provided by legislatures, supreme audit institutions, and the public, for example by making sure that these bodies are adequately funded and institutionally independent and that their assessments are made public in a timely manner.

Figure 2. ACT budgets need more transparency.

(Open Budget Index Score, 2012)



Source: Open Budget Initiative.

Increased use of online solutions. ACT governments could make more use of online solutions to support transparency and the quality of government services. In 2012, the ACTs ranked on average 119th out of 192 countries included in the United Nation’s E-Government Survey, which measures the willingness and capacity of national administrations to use information and communication technology to deliver public services.⁶ Interestingly, for ACTs, resource constraints do not seem to be

⁴ http://www.finances.gov.tn/images/le_budget_citoyensmallpdf.com.pdf

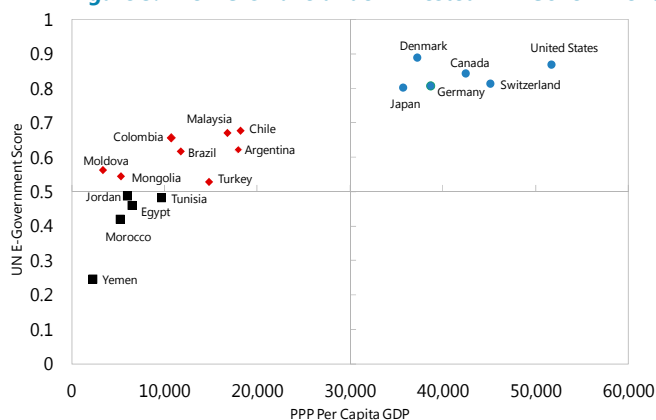
⁵ Information on emergency budgets should also be published; these are done outside the regular budget process and can be sizeable and important ways of circumventing budget discipline.

⁶ It is based on a comprehensive survey of the online presence of all 193 UN Member States, which assesses the technical features of national websites as well as e-government policies and strategies applied in general and by specific sectors for delivery of essential services.

the cause of the lag—economies at similar income levels have higher rankings on the index (Figure 3). E-government programs across the region could usefully be stepped up to:

- Disseminate information in a more timely and more consistent way;
- Increase the productivity of public services and the productivity of their users; and
- Reduce opportunities for corruption, as online operations minimize interactions between citizens and public officials.

Figure 3. The ACTs have under-invested in E-Government.

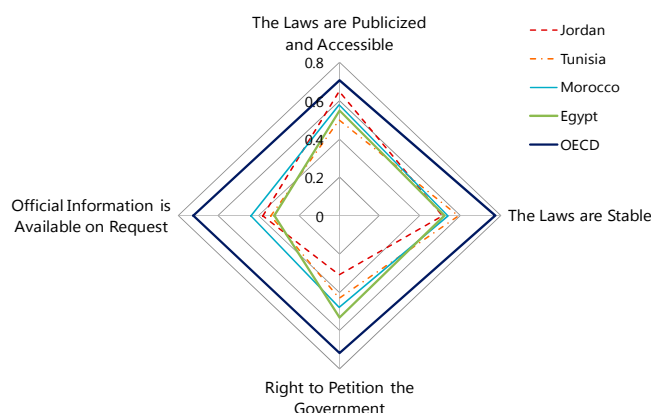


Sources: UNPAN; and IMF staff calculations

Greater legal transparency to engage stakeholders. ACTs rank on average 84th out of 148 countries on the World Economic Forum’s Transparent Policymaking Indicator, and also show weak results⁷ in readings of the Open Government Indicator of the World Justice Project’s Rule of Law Index (Figure 4). To improve legal transparency, ACT governments could:

- Give citizens better access to official drafts of new laws and regulations, not only as legal right but also in practice;
- Enhance opportunities for petitions prior to the finalization of new laws; and
- Improve public access to judgments in court cases. The publication of judgments has been found to be associated with stronger rule of law and greater control of corruption, and has also been credited with improving the efficiency of courts (World Bank, 2012).

Figure 4. Changes in laws and regulations are difficult to follow in the ACTs.



Source: World Justice Project.

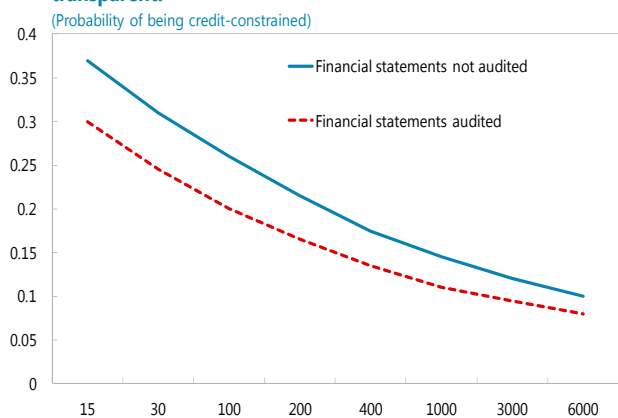
⁷ This variable measures how easy it is for businesses to obtain information regarding changes in government policies and regulations. The values range from 1 to 7 where the lowest value (1) means that gaining access to the information is impossible, and the highest value (7) means that it is extremely easy. These values are then transformed into ordinal rankings with 1 representing the best ranking and 148 the worst.

B. Supporting resource allocation and competition in the private sector

Stronger corporate disclosure requirements, and strengthened auditing and reporting standards.

Firms in the MENA region disclose less information than their peers in other parts of the world. ACTs score on average 5 out of the 10 points that are achievable in the reading of the World Bank Doing Business Disclosure Index for public companies. As shown in Figure 5, this makes it difficult for investors to distinguish more promising business ideas from those that are less promising and, ultimately, leads to lower lending and investment (La Porta, 1997; World Bank, 2009; Claessens and others, 2013). Low transparency in the operations of both enterprises and banks can also result in high numbers of nonperforming loans. Moreover, the ACTs still have some way to go on strengthening auditing and reporting standards (Figure 6).

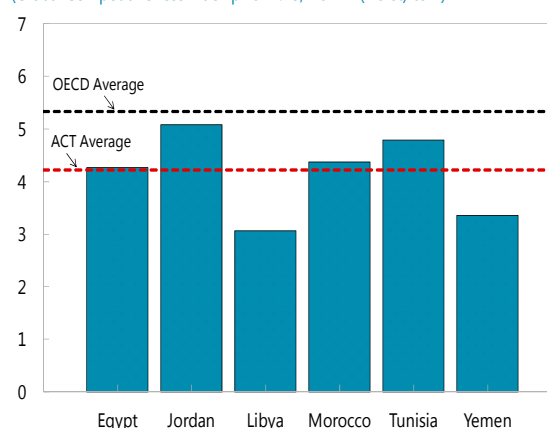
Figure 5. Firms can access more finance when they are more transparent.



Source: World Bank - "From Privilege to Competition: Unlocking Private-Led Growth in the Middle East and North Africa."

Figure 6. The ACTs lag behind in auditing and reporting standards.

(Global Competitiveness Index pillar 1.18, from 1 (worst) to 7)



Source: World Economic Forum.

Better credit information to promote access to finance and reduce costs. A survey of banks in the MENA region revealed that only 8 percent of bank lending is currently directed to small- and medium-sized firms (SMEs), the main engines of job creation in the developing world (Rocha, 2011). Weak credit information and creditor rights are routinely identified among the most important reasons why banks are so hesitant to lend. Most ACTs depend on traditional public credit registries, and even the countries that have introduced private credit bureaus are lagging behind other regions in coverage and quality of information (Madeddu, 2010).⁸

⁸ There have already been improvements in credit information with the introduction of private credit bureaus (PCBs) in Egypt and Morocco, the enacting of a customized credit reporting law in Jordan (in preparation for creation of a PCB in 2014), and the upgrade of the public credit registry (PCR) in Tunisia. Nevertheless, more needs to be done to improve the coverage and depth of credit information, especially for SMEs: data contribution in credit reporting should be mandatory and should include all loans; positive and negative data should be available; utilities and telecommunications providers should be included; and PCBs should be given incentives to develop value-added services (such as credit scores and ratings of SMEs).

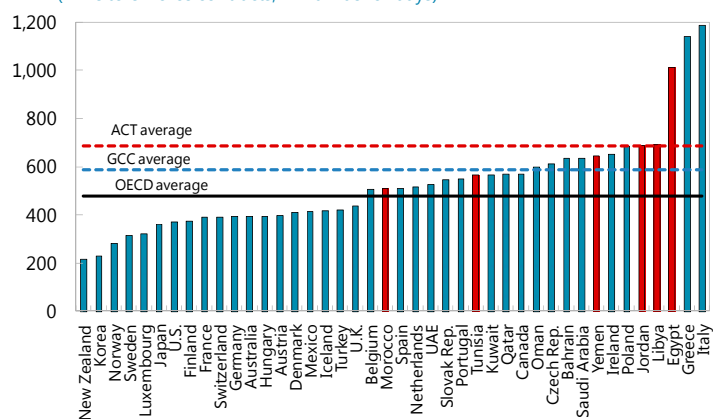
Consistent and predictable enforcement of rules. The World Bank’s Enterprise Surveys conducted in the MENA region have revealed that firms report an uneven playing field that favors incumbents. Respondents complained of inconsistent and unpredictable implementation of rules and regulations (World Bank, 2009). This is harmful in particular for SMEs, as they tend to suffer disproportionately from such practices (Hallward-Driemeier, 2011), and is likely to discourage new entrants.

More efficient courts. Some ACTs suffer from long delays in contract enforcement (Figure 7). This not only undermines the rule of law; it also has economic consequences. Where court delays are significant, commercial disputes and insolvency cases take longer to resolve, resulting in a greater depreciation of the assets under dispute. In addition, court delays affect firms indirectly. For example, differences in the enforcement of collateral have been found to adversely affect the size, maturity, and interest rates charged on bank loans (Bae and others, 2009).

Moreover, evidence suggests that firms in weak contract enforcement environments tend to produce and export relatively fewer customized and sophisticated products (Nunn, 2007).

Figure 7. Enforcing a contract in the ACTs takes a long time.

(Time to enforce contracts, in number of days)



Source: Doing Business.

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