



The Political Economy of Governance in the Euro-Mediterranean Partnership

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New Challenges: Domestic Reforms

Working Package Summary: Working Package 7 Domestic Reforms in Mediterranean Partner Countries of the European Union

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1. Introduction

This is a synthesis of the findings of the five reports contained in working package seven, which focused on Middle Eastern and North African countries. The five reports covered, the political and economic reforms undertaken in the region; assessing and discussing their impacts and requirements for another generation of reforms, before tackling the case study of Jordan.

This synthetic report introduces first the main findings of the five individual reports, and second the policy implications of these findings before making policy recommendations.

2. Executive Summary

The results attained in the first two reports, authored by our Polish partners stem from an analysis of the progress of political and economic reforms in the Mediterranean Partner Countries (MPCs) and MENA countries. These descriptions consider the background experience gained from transformations in the East Central European states in their consecutive stages.

Generally the progress of reforms in MENA is evaluated as a medium advancement, which can be shown by both political as well as economic assessments. Moreover, there is a certain diversification of the reforms among the group of states covered by the research. Rankings are similar for all countries. They indicate strong interdependence between advancement of political and economic reforms. Additionally, it could be assumed that the progress of reforms in the political field as well as in the economy is closely linked with level of liberalisation (internal and external) of the economy and its external relations.

The two reports developed by the teams from Poland rely on indicators and measurements that were issued by specialized centres. Nevertheless, some of the indicators are incomplete and do not cover all the countries that are included in the research.

These two papers show the advancement of the reforms in the political as well as the economic field. It gives a ranking of states using the criteria of advancement of the reforms. Finally, it shows where the weaknesses of the reforms lie and what should be done to introduce improvements.

The objectives of the third report, from our Moroccan partners, is to analyse the impact of the domestic reforms that have been undertaken by the Mediterranean Partner Countries (MPCs) and the Middle Eastern and North African countries (MENA) during the period 1995-2005. In

the context of this report, reforms include economic, political and social changes that have been carried out in these countries during the above study period. This is to allow for the identification of areas where further reforms are needed as the strengthening of the economies around the Mediterranean area requires continuous investigations that look at different sides of the reforms undertaken. This report is devoted to ensuring that these economies are responsive to the challenges of development and of partnerships with the rest of the world, especially the European Union.

The methods pursued in the assessment of the impacts of reforms are simple descriptive statistics, trend determination and regression analysis with most of the time cross-section and yearly data on international indices that cover economic, political and social reforms and effects.

The results obtained show globally and for the entire region that political and social indicators have not been significantly and positively changed but economic indices have captured minor positive effects. However, this overall result exhibits major variations by country. Economies that are non-oil producing and non-oil exporting have suffered more during the study period while oil exporters have had only political and governance deficiencies. Globally and at the national level, gender, health and education have appeared to constitute major deficits. Furthermore, high interdependencies between economic, social and political indices have been shown over the period 1995-2005. This implies that MPCs and MENA countries could benefit from important sources of development under further integrated policies and reforms.

Furthermore it suggests that the reforms undertaken before and during the study period have not contributed to the reduction of the pressure of social issues. As gender, health and education are concerned, the future development of these economies is at risk and more emphasis needs to be placed on reforms that can lead to the improvement of the livelihood of current and future generations. In this context, the partnership between MPCs and MENA countries and EU is central. Domestic economic, social and political reforms can be accelerated in their implementation as a result of the partnership and the positive outcomes of these reforms. The reduction of all types of inertia that negatively affect the promotion of reforms and of their implementation is a necessity in these countries. More competitive and transparent markets and institutional systems are likely to create conditions for the transformation of situations of rents, besides the mobilization and inclusion of more players in the economy and society. Women should be recognised as major actors in the process. Further directions for future generations of reforms are also discussed at the end of this report.

The aim of the fourth paper is to provide a general overview of the nature of domestic reforms that Mediterranean Partner Countries are facing today, and to cast new light on some of the obstacles affecting these economies in their attempt to conform to Euro-Mediterranean Partnership requirements and to turn what is nowadays a simple macroeconomic growth strategy into a real development process.

The paper focuses more systematically on the Arab Mediterranean Partner Countries, and relies on the research and publications of *World Bank* and *Agence Française du Développement*, and the use they made respectively of (1) Governance Indicators of the World Bank Institute, (2) the database “*profils Institutionnels*” of the French Ministry of Finance.

This study suggests expanding the reforms of the “first generation” (mainly intended to initiate the improvement of market mechanisms in economies until then strongly regulated by state) by reforms which go right through the heart of productive systems. This “second generation” of reforms aims at expanding market mechanisms. Therefore, these reforms, unlike the first ones, directly affect, not only the economic system, but the very way of functioning of the societies as a whole, and concern a high number of agents.

This deep differences between the two stages of reforms explains why the present stage is so hard to improve. In this case, obstacles must be researched not only in relation to the failure of governance, but in the dysfunction of the institutional area as a whole, notably in its ability to produce confidence within the economic system.

The fifth report appears to be supporting the analyses pursued in the third and fourth reports. It focuses mainly on the case of Jordan as a semi-rent-seeking economy where the reforms and their implementation are directly related to the existence of rents that affect the political economy of Jordan. This is a contribution that is established on arguments based on both previous literature and on sound data.

3. Major Findings of Individual Reports

The region has been affected by a series of reforms that include both political and economic dimensions. These have mainly concerned political and economic liberalisation of the economies along the line of those reforms pursued in other developing countries. The social reforms were limited except in some countries, but most of the assessments of impacts have shown weak positive social implications. Even though the impacts of the reforms undertaken so far have been modest during the study period, their continuation within a new generation of reforms appears to be a necessity.

Paper 1, Poland: “Pro-democratic domestic reforms in the Mediterranean Partnership Countries”

Greater pressures on political transformation in the region came from series of factors that are both internal and external. The need for reforms was certainly enhanced by the internal economic situation with high unemployment rates, poor education system adjustments to the global economy requirements, low levels of Foreign Direct Investment (FDI) and other socioeconomic factors. Moreover, the Arab Human Development Reports were highly critical and reflected the necessity of more genuine reforms. The willingness of some governments to liberalise their political systems can be also attributed to new leadership in Morocco, Jordan, Syria, Saudi-Arabia and Bahrain since the late 1990s.

To understand the mechanisms of the reforms already introduced to the political systems, one has to become familiarised with the concept of the liberalised autocratic systems present in most of the Mediterranean countries. This kind of system can be placed between: a full autocratic regime, in which there are no citizen freedoms and no openness for political competition; and full democracy, which covers among others free, fair, equal and regular elections, respect for human rights, civilian freedoms and accountability of the authorities. Liberal autocracy tolerates and promotes some level of political openness, introducing competitive elections, universal suffrage, enhanced women’s rights and civilian freedoms.

Conclusions based on the graph of Daniel Brumberg (2003) lead to the comment that most of the region can be characterized as liberalised autocracies and therefore sustaining liberalisation strategies. While Syria, Libya, Tunisia, Saudi Arabia are at the less liberal end of the scale of liberal autocracies, Egypt, Jordan, Kuwait and Morocco occupies the other end of the ranking, with Morocco being the most advanced.

One series of restrictions to political reforms has been identified in the fragmentation of civil society in these countries, there are however others. These restrictions impose implicit costs that vary from one country to another and depend on different factors such as the longevity of the liberalised autocracy, size of population and level of economic crisis. But, most of these countries are classified by the Freedom House as “partly free” states.

Paper 2, Poland: “Economic Domestic Reforms in Mediterranean Partner Countries”

The reforms analysed pertain to trade, exchange rates and privatisation. The reforms of the agricultural sector in MPCs are pursued within the framework of two simultaneous and interlocking processes: the implementation of commitments under the WTO and the prospects of Euro-Mediterranean Free Trade Areas. These two pending developments determine any progress in furthering reforms in agriculture.

Nevertheless, the MPCs are continuing their policies of liberalizing markets and reducing state intervention. Many of them are moving towards opening their borders by reducing the protection of products in most sectors. This is the case in particular with Tunisia, Lebanon and Egypt. Turkey is in the process of completing the dismantling of state commodity marketing monopolies. A certain increase in export subsidies has taken place in Egypt and Lebanon, although it is generally used to a limited extent in these countries.

Differences in economic, geographical and social developments are a major basis for political domestic pressure towards protectionism in agricultural sector, which is highly protected in MENA countries.

Trade in agriculture is a key sector in most of the MPCs, for which the EU is the principal export market. So far no defined prospect for the liberalisation of agriculture has been stressed under the Barcelona Process, and there have also been no significant new concessions made by the EU for agricultural products in the Euro-Mediterranean Association Agreements (EMMA). On agriculture and fisheries, new arrangements call for a gradual and reciprocal liberalisation while offering limited improvements to access of the EU market. Nevertheless some modest concessions were offered to Tunisia and Morocco, and significant reciprocal improvements are included in the EMMA with Egypt. On a multilateral level, negotiations on agricultural trade liberalisation are conducted under the WTO Doha Development Agenda (DDA). The outcomes of the DDA will have a significant impact on liberalisation processes in the MPCs. The engagement of the MENA countries with the WTO resulted in their

recognition of tariffs (the conversion of non-tariff measures to tariffs) and the reduction of domestic support in agriculture.

Most MENA countries have pegged their currencies more or less continuously to the US dollar, although more of their trade is typically with the European Union countries than with the United States. The Euro-Med agreements which have been signed in recent years between the EU and MENA countries are likely, over the next decade, to have a considerable positive influence on the flows of trade and investments between the EU and the MENA countries. In addition, the emergence of the Euro and the Euro-zone means that there is now, for the first time, a substantial and viable alternative anchor currency for these countries. On the other hand, according to the IMF experts, many countries from the MENA region should focus on the process of transformation to more flexible exchange rate regimes. Hence, it is important for the authorities in these countries to consider not only the desirability of a peg to the Euro, but also that of other alternative possible exchange rate regimes, such as regional currency unions, on the one hand, and genuine floats, on the other. A strong argument for introducing free floating regimes in this region is that the pegging regimes can be quite unstable in MENA countries, because of the relative volatility of MENA countries' currencies against the US dollar and against the Euro. While, for example, Egypt tends to exhibit long-lasting lower volatility against the US dollar than against the Euro, the same is not true for Morocco, Algeria and Tunisia, as these countries exhibit much more volatile apparent pegging (and a more Euro-oriented pegging in the case of Morocco).

In most cases, the first privatisation laws were introduced at the end of the eighties and the beginning of the nineties. Despite the entrance of special laws the process began with a considerable delay. In Morocco, for example, the privatisation law was accepted by the Parliament in 1989 but it took 4 years to proceed to the first operation. In Egypt, the acceptance of the law on privatisation was in 1991 and even though the process was launched during the same year, the pace of privatisation was extremely slow. So, due to this fact, the actual date of launching the privatisation process was 1996. The first part of the privatisation process brought very modest effects as well as proceeds. The process was re-energized, first by Morocco in 1999 then followed by Jordan and Egypt in 2000. At that time also Lebanon and Algeria joined the ranks of the declared privateers. Nevertheless, there wasn't much progress in this matter. Lebanon recorded probably the poorest results in the transfer from public to private ownership. There were only approximately 2 transfers carried out in the period 1988-2005. Lebanon introduced one of its first privatisation laws in 1999 but despite this fact it still had to implement special formulas delivering transparency and fairness in the

process. Algeria on the other hand gathered the most modest proceeds from its 3 first privatisation operations until 2000. In 2006 Lebanon started its privatisation push. The objective of this push was to attract foreign funds. Lebanon struggles under considerable public debt and privatisation is about to be a cure for that. Optimistic plans for 2006 privatisation (selling of telecommunications and companies and flagship carrier Middle East Airlines was planned for 2006) were destroyed by the 2006 war with Israel. Telecommunication privatisation is still on track, as it is supposed to ease considerably the public debt and bring additional revenues to the budget. This is also the IMF's opinion since it suggested in 2007 that the Lebanese privatisation program is the best way to cut debt, a core element of the overall strategy and an instrument to raise growth.

Laws accepted by the governments established the legal basis for selling off state assets. In Lebanon for example the law was based on internationally approved principles. Laws draw up lists of state owned enterprises chosen first for the transfer. The number of entities given over to the process differed between the countries. Due to the slow pace, and despite the early introduction of the privatisation laws, most of the MPCs did not accomplish the full privatisation plan.

Taking into consideration the biggest proceeds from privatisation in the developing countries one notices that although the process started in the early 90s, none of the MENA countries was placed among the biggest revenue-generating countries. This simply proves the fact that the pace of MENA privatisation in its early stages was extremely slow and insignificant. The process was started belatedly and with reluctance. Statistics show that the MENA region lagged behind comparable regions such as Latin America and Caribbean (LAC). Between 1990 and 2003 LAC received 47% of world's privatisation proceeds whereas MENA received only 5%. This relation changed in years 2004-2005 when the MENA took 8% and the LAC only 3%. The result of 8% is still not satisfactory but shows a degree of progress. It indicates that the region under consideration speeded up the pace of reform. Also a number of transfer transactions prove this statement. In the World Bank Top 10 revenue-generating countries statistics for the period 2000-2003, Morocco was included as the only representative of the MENA region.

Paper 3, Morocco: “Overview & Discussion of Impacts of Domestic Reforms in Mediterranean Partner Countries of the European Union”

This section of the report introduces the outcomes of the analysis. It is composed of three parts that deal respectively with the overall results, the major criticisms, and the variations of results between countries.

During the period considered in this analysis, the MENA region has shown stagnant to enhanced economic performance, with population pressure expressed by both a higher fertility rate and high demographic mobility as major challenges. The higher mobility of the population both inside and outside the region is related to economic factors but also to the lack of security due to political and military conflicts. The external annual flows show on average that Algeria, Syria, Yemen, Egypt, Jordan, the Palestinian Authority, Tunisia, Morocco and Lebanon are countries of emigration while Bahrain, Israel, Kuwait, Oman, Qatar, Saudi Arabia and Libya are economies that receive immigrants.

Rapid urbanisation with limited infrastructure and the absence of basic requirements for life has also contributed to the acceleration of urban congestion where higher costs and higher efforts for accessing goods, services and facilities face all the residents. The high costs of access are critical and are at the origin of the exclusion of the poorest segments of the population. They are also leading to higher levels of urban congestion and degradation of living conditions in the cities concerned.

The above findings show that some areas can be critical to the MENA countries. The main critical sectors are related to gender, education and health care.

This overall picture that shows clearly that the likely effects of economic, social and political changes that took place before or during the study period may not be complete without observing the central role of gender in the overall development process. As said in earlier works, even the futures of these societies is at risk given that current girls and current mothers suffer implicit and explicit discrimination that is persisting.

This discrimination is expressed through low levels of schooling for girls with high dropout levels, and through the general living conditions of females. Exclusion not just from business opportunities as rent economies persist in this region, but also from political and social participation in their countries' development. Females suffer the most from these types of exclusion, with implicit and explicit social costs imposed economically, socially and politically on these countries. Such a situation has pushed internal and external observers of this region to suggest new generations of reforms that emphasize the development of

democracy and of private markets through further economic openness, trade development and reduction of the role of traditional governments.

Education and health care appear to have largely benefited from large public budget shares in each MENA country. But the outcomes and the quality of the education and health services appear to be not consistent with this high level of the commitment of the public sectors in these countries. Most reports and publications refer to the high level of segmentation of educational and health care services in the MENA region, mainly when analysing the services provided in relation to private international corporations.

The overall situation of health and health care has been made more complex when accounting for the transitional diseases and epidemics that are related to urbanization and new modes of life and consumption that are developing worldwide and in this region.

While the above findings are global, these results appeared to vary by group of countries. A large number of countries with excessive resources (mainly oil) and labour deficits can show good to very good economic and investment performances. The attained results can then help enhance economic, political and social dimensions of development both domestically and internationally. This latter orientation has been recently enriched with the development of business investments and contributions to social programs (oil exporters from MENA region investing in North Africa). The other sets of countries (1- non-oil exporters with the existence of excessive labour; 2- owning valuable resources but cannot benefit from the excess labour) are expected to have fluctuating economic, social and political outcomes and this is clearly apparent in the available data. The effects of higher oil revenues have certainly induced a higher demand for labour (both skilled and unskilled) except in those economies that benefit already from excess labour (i.e.: Algeria). This trend can be directly related to the development of domestic and foreign direct investments in these countries. In contrast with the above observation, non-oil exporters and especially those with excess labour have not shown signs of change in the labour force that are beyond the natural demographic rate. These elements are again revealed when accounting for the share of expatriates in the labour force operating in oil exporting countries.

The findings in this part of the report show the existence of interdependencies between different types of reforms. They also show that the countries under study still have important opportunities for improving their social conditions. For all MPCs, it appears clearly that higher economic gains can be achieved through improvements in life expectancy at birth. As life expectancy at birth is directly related to health, health expenditures as well as infant mortality showed significant and meaningful relationships with economic performance. Both

global and national results show the impacts of health variables on overall economic performance. These impacts are shown to be promising during the study period. Improvements in health expenditures, in infant mortality and in life expectancy lead certainly to improvement in economic performance globally and at each country level with few variations across countries. This says that the impacts of reforms did not show negative social effects.

These analyses show how in recent years, the South Mediterranean region has tackled social reforms that are beneficial to the populations, as health is a cornerstone in development. These results show also that there is still room for further reforms and changes in this direction because of the high level of observed responses. But, even with these results, social actions and especially health concerns appear to be conducted separately from other related policies.

Paper 4, France: “Arab Mediterranean Countries facing the "second generation" of Reforms: A Political Economy Standpoint”

It is possible to introduce competitive pressure into the productive systems of MPC (particularly by the way of commercial opening) in order to limit the negative impacts of rents. These rents were formed under the cover of custom protection and government intervention. The competitive pressure creates powerful leverages to create institutional transformations that need to accompany factors reallocations.

But, it is observed that MPCs are still having difficulties implementing what is in fact a new mode of functioning of their economies, and more largely a new social contract for their societies. These obstacles are shown when analysing the relationships between (1) the functioning of productive systems, (2) the structure and the functioning of financial system, (3) finally the modes of state intervention within the economic system. These complementarities define the outlines of a particular model of mixed economy, that one could qualify as both a “family-centred” and an “authoritarian-paternalistic” capitalism.

Moreover, as far as governance is concerned, Arab Mediterranean countries show relatively good performances. The available indicators show that these countries have equal or sometimes better levels than other developing countries. But, the Arab countries suffer from the existence of important delays in democratic reforms (indicator of democracy), compared to other developing countries.

Furthermore, the indices related to institutional agreements, and to the social contracts, show weaknesses in relation to reforms and socio-economic conditions. Particularly, a major obstacle in the implementation of an authentic development process can be found in the deficient production of confidence in these countries, as confidence is a key element of long-term growth.

In these countries confidence is produced and shared on the sole basis of personal relationships. Rules are generally tacit, abstract and not written. This shows the need for the strengthening of the implementation of laws with the recognition of the roles of states as strategic regulators and coordinators. The problem is therefore to convince political and economic groups of the relevance of these policies and their positive social and economic impacts in different societies.

Paper 5, Jordan: “The Process of Economic Reform in Jordan 1990-2005”

The fact that Jordan is a semi-rentier and patrimonial society made the process of reform slower than expected and the potential to retract high. Moreover, the same old regime took the role of new champion to advocate the new policies which made reform especially difficult. This is very different from the case in former socialist European countries, for example, where new regimes discarded the old policies unreservedly. However, the severity of the economic crisis and the persistence of IMF and WB conditionality ensured that the process remained on track.

A strong coalition of bureaucrats stands to lose from the reform measures. Therefore, it is no surprise that this group vehemently resisted the reform throughout the various phases of the process. Maintaining the status quo served bureaucrats' narrow interest better than jumping into the unknown. However, when the political leadership showed a strong commitment to reform, the process speeded up. This is what is currently observed.

From its end, the private sector was not ready to adhere to the new rules of competition and seemed to prefer the clientist and patrimonial relations that were developed with the state before the reform process kicked off. Moreover, the continued tension between the private and public sector has negatively influenced the private response to government initiatives.

Civil society organizations, which are huge in number, have been inefficient or inactive in stepping in to fill the vacuum created by over-centralized government functioning and private sector reluctance to come forward. This has resulted in a limited and insignificant role for the

civil society organizations during a period that should have witnessed their active participation in the decision-making process.

As the country continues to open up with the aim of deregulating most of its sectors before 2012, the challenges ahead are many. As the processes of liberalisation and privatisation continue and the government continues to redefine its social role, issues such as social equity, inclusion of various stakeholders and political participation are increasingly attracting attention and surfacing as significant domestic conditions that will shape the future of the reform process.

4. Policy Recommendations

While further reforms are needed for the region studied, the results of the impact assessment show that their acceleration is promising for the realization of economic, social and political objectives for satisfying both the needs of larger segments of the population and the requirements of globalization and openness. The high direct and indirect social costs related to the historical, on-going and new conflicts are likely to further affect economic, political and social reforms in the region. Solutions to these conflicts are among the priorities in this region. These solutions should account for the interests of different parties and could not be resolved without total participation, with full dignity, of all the concerned parties. Water should be accessed by all populations in conformity with their current and future needs. But, new other challenges are facing all the world economies and especially those pertaining to this region of the world. These signals include the major price trap into which most countries are entering, with a special role devoted to the MENA zone:

- Higher food prices and their implications in terms of assessing the competitive benefits and advantages of different types of economies in the South of the Mediterranean area. This issue may not be related only to yearly shortages due to limited supply of food but to the higher world demand as related to higher standard of living developed through the emergence of new economies, the high rate of urbanization but also the new technological alternatives for using food as inputs for new energy and manufacturing processes,
- Higher oil prices as long as a large number of cheaper sources of energy are not fully developed. This in return affects also food prices and sustains the spiral of higher costs for producing food items.

Besides these signals, the flow of information and the high speed of its diffusion in almost real time, create new conditions for world population to access information and enhance its perceptions and expectation formation about every economic, political and social issue. The MENA region is also part of this process as most of the issues could not be perceived under an area of extensive government intervention and economic autarky, but where perceptions and expectation formation are easily made under the openness of these economies even though large segments of the populations are still illiterate and outside the education system. The increasing roles of civil society through multiple associations, unions, political parties and enterprises of media are recognised to be important means for this transformation. They all tackle domestic and international questions from inside and outside these countries.

Within this new framework, the new neighbourhood policies and reforms that can strengthen win-win solutions for both the European Union and their Mediterranean partners can create new conditions that need to be considered within a new wave of reforms:

- Further openness and liberalisation of these economies are needed with more transparency and increasing freedoms of individuals and groups;
- Reforms and actions that would facilitate access to markets, businesses and to institutions in more merit base with larger levels of competition;
- Integrated reforms and policies where economic; social and political reforms are conducted simultaneously;
- South-south integration is an important part of North-South partnership: Energy, food and water can be important drivers for accelerating this integrations;
- Education, health, knowledge and culture can be central to the reforms to be undertaken for both the enhancement of domestic development, bilateral and multilateral cooperation and partnerships in the region;
- The strengthening of research in the social sciences is likely to ensure relevant flows of knowledge useful for education and for development.

5. Conclusion

The above study shows that the MENA region and the MPCs face social problems that are directly related to economic and political concerns. The reforms undertaken before 1995 and during the 1995-2005 periods have not had significant positive impacts on the living conditions of the populations in these regions of the world. Education, health and gender

related issues appear to be among the factors that have constrained and reduced the attainment of decent living conditions. Non-oil exporters and countries with excess labour supply have suffered more than the oil exporters and countries with labour deficits. This places more pressure on the former types of countries to reform further their economies and political systems in order to generate promising positive impacts of the reforms. Oil exporters, even though they have been diversifying their economies, are still benefiting from high oil prices and delaying the reforms of their political and social systems. Non-oil exporters and excess labour countries have had more incentives to proceed with reforms of both the economic and political systems. But the experience accumulated has shown that the speed of reforms as well as the expected responses are very slow and sometimes very limited in extent and amplitude. Different hypotheses have been made in relation to this slow rate of transformation and to the limited impacts of these reforms. Among these hypotheses, market imperfections and incompleteness, besides situations of rents owned and used by different groups of interests, are suggested. The nature of the political economy prevailing in each country is likely to be the source of explanation. Some of these countries (Morocco, Jordan and Egypt) have been also tackling the social issues through specific policies. Several structural factors such as the development of civil society in these countries, besides programs targeting poverty and inclusion of women, are likely to create promising conditions for enlarging access to better living conditions.

The integration of policies and reforms has appeared to become a necessity as shown from the analysis conducted above. This analysis based on the last 11 years has shown high levels of interdependencies between different indicators that represent economic, social and political dimensions. The levels of responses attained are promising indicators of the existence of major sources of improvements that need to create more incentives for these countries to pursue further reforms.

6. References

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