

Economic Freedom Report (2010)

Assessment from a Palestinian Perspective

Objectives

This paper is intended to serve the following objectives

- Conduct an objective review of the report published by Fraser Institute on "Economic Freedom of the Arab World – 2010", mainly from a Palestinian perspective.
- Propose appropriate institutional means of managing the Palestinian connection with this project, whether in terms of providing required data or disseminating the report among end users.

In order to achieve the above-mentioned objectives, the Economic Freedom Report was first discussed in a workshop sponsored by Friedrich Naumann Foundation (Jerusalem), which was attended by senior experts and officials from relevant Palestinian institutions. The author of this paper has benefited from the presentations made at the workshop and the subsequent remarks made by the participants. Additional amendments might be introduced later in view of feedback coming out from a forthcoming focus group meeting involving a select group of local experts. Again, this meeting will be sponsored by Friedrich Naumann Foundation in Jerusalem.

The structure of the index

The index published in the Economic Freedom of the Arab World Report includes five thematic areas, comprising a total of 39 components. The score for each of the five areas is derived by averaging the components within that area. The most recent data available for this report are from 2008.

The five areas, assessed include the following:

- Area 1: Size of Government: Expenditures, Taxes and Enterprises;
- Area 2: Commercial and Economic Law and Security of Property Rights;
- Area 3: Access to Sound Money;
- Area 4: Freedom to Trade Internationally;
- Area 5: Regulation of Credit, Labor, and Business.

The index published in Economic Freedom of the Arab World report includes data for the 22 member countries in the League of Arab States.

Definition of Economic Freedom

The publishers of the Report argue that economic freedom is fulfilled when two fundamental underpinnings are satisfied, namely:

- a. When property acquired without the use of force, fraud, or theft is protected from physical invasions of others, and,*
- b. When the owners of such property are free to use, exchange, or give their property, as long as their actions do not violate the identical rights of others.*

While one can easily understand the long historical background for this definition, yet one should still raise several basic ideological questions, mainly the following:

1. It is clear that safeguards on the legitimacy of ownership of property and other forms of wealth are often so broad and vague that they leave ample space for premeditated abuse. This is especially serious in view of the fact that no mention is made in the Report of compliance with governance codes and business ethics, nor the relevant legal frameworks in the respective countries, such as those relating to direct and indirect taxes, quality standards, and anti-trust laws.
2. The above definition overlooks the stunning facts on the ground relative to the huge wealths amassed by relatives of political leaders in nearly all Arab countries. The strong men (and women) surrounding totalitarian rulers can always claim that the means of acquisition of their wealth did not involve “use of force, fraud or theft”. Yet the recent revelations in some Arab countries provide ample evidence to suggest a very different conclusion. Certainly what the Mubarak brothers have been doing in Egypt for tens of years is not a rare phenomenon in the Arab world.
3. Similarly, the conditions attached to freedom of property use are very loose. In addition to “not violating the identical rights of others”, the freedom of use by owners of property should also be bound by the legal frameworks observed in their countries.

So unless the means of acquiring property and using it are more elaborately defined, economic freedom is likely to be construed as a “legitimate” cover for serious forms of corruption. This is probably true every where, including most Arab countries.

Why economic freedom?

The report provides a strong and convincing case for advocating economic freedom (pages 10-12). Yet it is imperative to emphasize that commitment to economic freedom, cannot be taken as an excuse for not displaying adequate sensitivity to its social implications. The huge gaps in per capita income and living standards in nearly all Arab countries, including the poorer ones, should arouse constant concerns relative to wealth distribution policies, without necessarily compromising on the basic underpinning of economic freedom. Arab regimes have a lot more to learn in this connection from countries like France, Germany and the United States, which are among the champions of economic freedom in the world.

Sources of Palestinian data

The report provides a fairly long list of references for data relating to respective countries. It is noted though that there is no mention of Palestine in any of the cited references. It is further noted that none of the reports published by the Palestinian Central Bureau of Statistics has been cited in the list of references, although PCBS is one of the most active national statistical bodies in the Arab countries. Furthermore, the numerous reports published specifically on Palestine by the World Bank and IMF have not been referred to. This includes the “Doing Business Report” published by the World Bank specifically on Palestine.

Assessment of Palestinian data

The scores relative to Palestine in the Economic Freedom Report – 2010 are summarized in Annex (1). Notwithstanding the ambiguity regarding their sources, the Palestinian data is likely to raise many methodological and substantive questions. The following is only a partial list:

1. Scope of coverage

Many indicators and sub-indicators have not been rated, despite the fact that Palestine has been during the past 16 years focal country on the agenda of many international organizations and donor countries. This has been clearly reflected by the enormous amount of statistical and research reports published on nearly all facets of the Palestinian society. It is therefore difficult to understand why the authors of the report could not find enough data on sub-indicators such as international trade, ownership of foreign currency, and foreign banks, when there is a profuse output on all of these topics.

2. Reliability of data

In the absence of any information on the of sources of data relative to Palestine, nearly all scores reported can be contested, especially by relevant local institutions. But some scores are particularly questionable, as indicated below:

2-1 The credibility of scores relating to “doing business” are highly questionable especially when compared with data published in the World Bank “Doing Business Report -2011”. The overall score of Palestine in the Economic Freedom Report (2010) is calculated at 7.6 on a score of 10. With this high score, Palestine ranks 3rd on a list of 22 Arab countries, i.e. preceded only by Bahrain and Kuwait (and equivalent to Lebanon).

But in sharp contrast to the EFR excessively positive Palestinian scores, the World Bank Doing Business Report (2011) provides very different estimates. According to this report, Palestine ranks 135 on a list of 183 countries with regard to “Ease of Doing Business”, 173 on “Starting a Business” and 183 with regard to “Closing a Business” – see Annex (2).

2-2 According to the EFR Report, Palestine’s score on "banking and credit market" is 5.8 (out of 10), with a rank of 16 (out of 22 Arab Countries). On the other hand, the rank of Palestine on the same indicator, as published in the World Bank Doing Business Report is 168, which is considerably lower than that in the EF Report. Clearly, it is the World Bank estimate which should be seriously questioned in this case. Commercial banks in Palestine are far more forthcoming on their credit policies than they had been in the past. This pronounced change in policies has commenced more than five years ago, and it has reached highly visible levels during the past two years. Not reflecting this objectively is likely to cause considerable distortion in the rating of Palestine’s investment climate.

2-3 The very high scores to some indicators in the EF Report, such as those relating to labor market regulations control (9 out of 10) raise many questions. In the absence

of information on collection methodologies, such estimates seem to be grossly inaccurate.

3. Tracking the magnitude of change in the scores and rank of Palestine between 2002 and 2008 would have been very useful, especially in view of the considerable transformations in the political and economic settings during this period. The Economic Freedom Report, however, does not provide adequate comparative data, especially for 2002. In fact most of the scores quoted for 2002 are either identical or very close to those of 2008, which clearly raises serious credibility questions.
4. The EF Report tends to display an overly soft attitude towards the economic policies and development track records of most Arab countries. In most cases the authors relay explanations and promises published in official reports at their face value, without raising questions about their credibility. The staggering plunders and failures encountered by most Arab countries with regard to their economic and fiscal policies are almost totally overlooked in the report.
5. Away from substantive remarks, one would question the way Palestine is referred to in the Economic Freedom Report, i.e. as West Bank and Gaza. It is clear that the publishers have simply opted to use the World Bank nomenclature, while ignoring the name used by a host of other UN bodies, which simply refer to both regions as "Palestine". Reducing the name of Palestine to "West Bank and Gaza" is not viewed as a fair gesture.

Recommendations

Although the Economic Freedom of the Arab World Report has been published annually since 2002, yet it is difficult to provide an objective assessment on its contribution with regard to promoting genuine economic freedom and social justice in the Arab World. By contrast, it is probably safe to assume that the recent uprisings in the Arab world are underlain in part by serious economic grievances, mostly those relating to poverty, unemployment and vast disparities in income distribution.

This paper has touched on some issues which bear on the credibility and usefulness of the Report. These remarks should be considered by the publishers in upcoming editions. But conforming with the main purpose defined for this paper, the following recommendations relate mainly to Palestine.

1. While the pioneering role of the (Omani) International Research Foundation should be duly recognized and commended, yet it is strongly recommended that the whole project be overseen by a pan-Arab committee of experts, to be sponsored by Friedrich Naumann. The members of such a committee could be identified by Friedrich Naumann local offices, possibly in collaboration with respective local partners. The Committee should be able to meet once a year, and pursue further interaction by resorting to various forms of communication technologies.
2. FNF Palestine is advised to identify a qualified local institution to undertake the assignment of collecting data and other input relative to Palestine. The collection process

will be based mainly on already published statistical output, although in some cases it may resort to primary sources.

3. It is strongly recommended that the conclusions and recommendations in this policy paper be discussed in a focus group meeting involving senior experts from the following institutions:

1. Palestinian Central Bureau of Statistics
2. Ministry of Planning
3. Ministry of Economy
4. Palestinian Economists Association
5. AMAN
6. Palestine Governance Institute
7. Friedrich Naumann Foundation

Feedback from this meeting will be duly incorporated in the final version of this paper.

Annex (1)

Economic Freedom Report (2010) Summary of Palestinian Indicators

Area 1 – Size of government, expenditure, taxes, and enterprise

	<u>2008</u>	<u>2002</u>
Overall score of Palestine (out of 10)	7.2	—
Overall rank (on a list of 22 Arab countries)	3	—

Scores on sub indicators:

• General government consumption spending	4.3	4.8
• Transfers and subsidies as a percentage of GDP	—	—
• Government enterprise and investment	—	—
• Top marginal tax rate	10	10

Area 2 – Commercial and economic law, and security of property rights

Overall score of Palestine	7.4	—
Overall rank	8	—

Scores on sub indicators:

• Military interference in rule of law and political process	—	—
• Integrity of the legal system	—	—
• Regulatory restrictions on the sale of real property	8.7	8.6
• Legal enforcement of contracts	6.0	6.0

Area 3 – Access to sound money

Overall score of Palestine	7.9	—
Overall rank	11	—

Scores on sub – indicators:

• Money growth	8.3	7.9
• Standard deviation of inflation	8.2	9.2
• Inflation – most recent years	7.3	8.9
• Freedom to own foreign currency bank accounts	—	—

Area 4 – Freedom to international trade

Overall score of Palestine	—	—
Overall rank	—	—

Scores on sub indicators:

• Taxes on international trade	—	—
• Black market exchange rates	—	—
• Capital controls	—	—

	<u>2008</u>	<u>2002</u>
Area 5 – Regulation of credit, labor, and Business		
Overall score of Palestine	7.4	—
Overall rank	7	—
Area 5-1 Credit market regulations	5.8	5.8
• Ownership of banks	—	—
• Foreign bank competition	—	—
• Interest rate controls	9	10.0
• Getting credit	2.5	1.7
Area 5-2 Labor market regulations	8.6	8.6
• Rigidity of employment index	6.9	6.9
• Mandated cost of hiring (% of salary)	10.0	10.0
• Mandated cost of worker dismissal (weeks of wages)	7.5	7.5
• Conscription	10.0	10.0
Area 5-3 Business regulations	7.9	6.7
• Starting a business	7.9	6.7
• Closing a business	—	—

Annex (2)

World Bank Doing Business Report - 2011 Ease of Doing Business Rank - Palestine

<u>Indicator</u>	<u>Rank (Out of 183 countries)</u>
Starting a business	173
Dealing with construction permits	157
Registering property	76
Getting credit	168
Protecting investors	44
Paying taxes	28
Trading across borders	111
Enforcing contracts	93
Closing a business	183

Ease of Doing Business (2011) Ranks of Selected Countries

<u>Rank</u>	<u>Country</u>
1	Singapore
5	United States
11	Saudi Arabia
22	Germany
29	Israel
50	Qatar
74	Kuwait
94	Egypt, Arab Rep.
111	Jordan
135	West Bank and Gaza
144	Syrian Arab Republic