Impediments to Dispute Resolution and Firms' Competitiveness in the MENA Region

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Abstract

This paper is based on the premise that private sector development is of crucial importance to the future development of MENA countries. It demonstrates the degree to which various institutional constraints, in general, and impediments to dispute resolution, in particular, reduce the competitiveness of private firms in the MENA region by increasing transaction costs. It describes existing dispute resolutions systems in the MENA region and the impediments to firm competitiveness resulting from their shortcomings. It identifies the three major alternative means of reducing the impediments and costs of dispute resolution, namely legal reform, judicial reform and "alternative dispute resolution" methods (ADRs). Each of these general approaches can take various forms, each form having certain necessary pre-conditions and advantages and disadvantages. Since MENA countries vary considerably in their existing environmental conditions and social objectives, no single approach is likely to be suitable for all. Moreover, individual entrepreneurs facing country-specific disputes may well prefer different approaches. While the paper focuses on MENA countries, it also addresses relevant methods of reform used in some Latin American, Eastern European and East Asian countries, which have been relatively more successful than others.

ملخص

يستند التحليل فى هذه الورقة على فرضية أساسية مؤداها أن نمو القطاع الخاص هو ضرورة حتمية بالنسبة للمستقبل الاقتصادى لدول الشرق الأوسط وشمال أفريقيا. وتبدأ الورقة بدراسة إلى أية درجة تؤدى المعوقات المؤسسية بوجه عام، وتلك المرتبطة بفض المنازعات بوجه خاص، إلى زيادة تكلفة المعاملات الاقتصادية وإلى إضعاف القدرة التنافسية للقطاع الخاص بمنطقة الشرق الأوسط وشمال أفريقيا. ثم تنتقل الورقة إلى دراسة أكثرتفصيلاً للمشاكل والمعوقات المرتبطة بفض المنازعات وإجراءات التقاضى وأثرها على القدرة التنافسية للمشروعات فى المنطقة. وإستكمالاً للتحليل تعرض الورقة عدة بدائل لتيسيير وتخفيض تكلفة فض المنازعات، معتمدة فى ذلك على بعض تجارب الإصلاح الناجحة فى أمريكا اللاتينية وأوروبا الشرقية ودول شرق آسيا. وبشكل أكثر تحديداً يتم إستعراض ثلاثة بدائل محددة للإصلاح هى: الإصلاح التشريعى، الإصلاح القضائى وأسلوب "بدائل فض النزاعات". كما تقدم الورقه تحليلاً مقارناً لهذه البدائل من حيث الشروط اللازم توافرها، والأشكال المختلفة ومزايا وعيوب كل بد يل. وتنتهى الورقة إلى أنه نظراً لإختلاف الخصائص العامة والأهداف الأجتماعية وطبيعة وتفضيلات المستثمرين بين دول الشرق الأوسط وشمال أفريقيا، فلا يمكن القول بوجود بديل واحد يصلح لكافة هذه الدول.

I. Introduction

Despite the considerable progress of the MENA region towards peace and political stability, the real GDP per capita has at best remained constant since 1985. This lack of economic growth is expressly due to population and labor force growth rates, which are the highest of any region in the world. The MENA region's performance has been no better than that of Sub-Saharan Africa and worse than that of all other regions except Eastern Europe.[1] Furthermore, with both the population growth momentum and the female labor force participation rate on the rise, rapid increase in the labor force is expected to continue for some time. As a result, MENA countries will have to substantially accelerate their economic growth rates if they are to avoid dangerously large increases in unemployment rates and further deterioration in labor productivity. Adding to this dilemma is the paradox that while the agricultural and service sectors of MENA economies are currently suffering from extreme underemployment, the open unemployment rates are by far the highest of any region in the world.[2]

Furthermore, despite a decade of talk about privatization, the MENA region also leads the world in the amount of wealth that remains in the state sector. Even at the margin – i.e., in terms of change in the stock of capital – more than half of the region's investment is still undertaken by the government. Yet, because of high debt to GDP ratios, on-going reductions of tariffs and other taxes, and the realization that the government cannot and should not extend its functions beyond the administrative capacity, it is the private sector that will have to provide both the impulse to that growth and the employment opportunities for the region's rapidly growing labor force.

There are, of course, two main strategies for achieving a transformation from state to private sector domination. One is privatization. Yet in many countries, this process has proved problematic because workers, managers, and bureaucrat-politicians often offer strong resistance. Even when privatization is not blocked in this way, it can occur only where the viable enterprises to be privatized will be of interest to the private sector in the end.

The other strategy is to create an attractive environment within which new private sector activities can develop. If MENA countries are to grow rapidly in the near future, it will require considerable structural change. Keeping in mind that even large privatized firms could play only a minor role in the future economy of the country[3], creating an appropriate environment for nurturing private sector activities is likely to be far more important than privatization.

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[1] See, e.g., Anderson and Martinez (1996), World Bank (1985, 1999a, p.164, 1999b).
[2] The open unemployment rate was estimated to average 15 percent in 1993 (World Bank, 1995).
[3] In rapidly growing South Korea, Krueger (1992) estimated that 80-90 percent of GDP in the mid-1970s was accounted for by factors of production which were employed in a very different activity in the early 1960s.

The creation of such an environment, however, requires a very substantial change in the role of the state. As Page, Saba, and Shafiq (1997) so aptly put it, the role will have to change "from player to referee". Only by withdrawing from the player role in favor of the referee role, which means getting the institutions "right", will MENA countries have a chance of developing the kind of environment that is conducive to a competitive, flourishing, and rapidly growing private sector. Getting institutions "right" means identifying, creating, monitoring, and enforcing the kinds of rules by which markets for new goods and services and productive factors can be created, nurtured, and made keenly competitive. Essentially, solid institutions will enable private firms to undertake the activities necessary to become internationally competitive.

Contrary to the assumption of traditional neoclassical economics, such institutions are vital to the efficient performance and growth of the economy. Yet, the creation of these institutions and their maintenance through monitoring and enforcement activities are by no means cost-less. Indeed, these "transaction" costs can be very sizable despite that each agent in the economy may be motivated to minimize them. In a primitive economy dominated by subsistence activities largely carried out within individual households, these transactions costs may be very low. Yet, as the volume and complexity of exchanges and contractual relationships (including those with governments and foreigners) increase, the importance of transaction costs increases substantially.[4] One component of these costs that grows especially rapidly in proportion to aggregate economic activity is the cost of dispute resolution.

As will be demonstrated below, MENA countries vary significantly in the extent to which they have made the necessary transitions in the role of the state and in identifying, implementing and enforcing the kinds of rules that can reduce transactions costs and encourage private sector development. Some have made very commendable progress in the last decade or so, especially in macroeconomic reforms, reducing budget deficits, stabilizing the money supply and reducing inflation. Some have also liberalized regulations, especially those on trade and capital flows, lowered tax rates and introduced new laws for investment and other activities of relevance to private sector development.[5] In general, however, we shall see from

[4] Wallis and North (1986) estimated such costs for the United States to have been about 22.5 percent of GNP in 1870 and to have risen to some 40.8 percent of GNP by 1970. Even though these costs may seem high, they do not include transport or transformation costs.

[5] According to Kanaan (1998), with its recent reforms in tariff reduction, tax reducti9on, financial market liberalization, securities market reform and privatization, Jordan was found to be a case in point. Indeed, a well-known consultancy – Stanford Research Institute International (SRII) – was asked to undertake a study that would resolve this paradox.

what entrepreneurs say, that the costs of dispute resolution have become an increasingly serious problem throughout the MENA region.

The paper is organized as follows: Section II compares the relative importance of different constraints on private sector competitiveness both in individual MENA countries and between MENA and other regions as reported by the entrepreneurs themselves. Section III provides background on the evolution and characterization of dispute resolution mechanisms in the MENA region. Section IV identifies the benefits and costs of each of these dispute resolution systems, different ways in which the costs can be reduced, and best practice examples wherever possible. The conclusions of the study are given in Section V.

II. What Firms Say About the Constrains on their Competitiveness

Because of the aforementioned success of most MENA countries in controlling inflation and fiscal deficits and in liberalizing trade, it might not seem that institutions and rule-setting would be a crucial problem. Indeed, government officials and international agencies have often used certain MENA countries, e.g., Jordan and Tunisia, as examples of how reforms should be undertaken. Consistent with this view, Table 1 shows that businessmen in the MENA region are the only ones who say that, "Inadequate supply of infrastructure" rather than unfriendly regulations of some sort was the most serious obstacle to doing business in these countries. Indeed, regulations on foreign currency, safety and environment, prices and even labor were found to be among the least important constraints by MENA businessmen. At first glance, therefore, institutional factors would not seem to be an important constraint on business activities.

If one digs a little deeper in these survey results, however, a different picture emerges; indeed, one in which institutional constraints in the MENA region are very important. For example, corruption was ranked the second most serious obstacle, tax regulations third, trade regulations fifth, and uncertainty of regulations sixth. For most of these categories, the MENA region's rankings of these obstacles were near the highest of all seven regions identified in the survey. Note also that, "regulations on starting new operations," even though placed lower down on the rankings, are viewed in MENA as a stronger obstacle to doing business than in any other region except South And South East Asia. However, it is important to note that Jordan, Morocco and the Palestinian territories, which all have relatively strong institutions, represented the MENA region in this survey. Had the sample been more representative of the

region, regulations would undoubtedly have been rated considerably greater obstacles to doing business than indicated by the scores reported in Table 1.

Table 1. Regional Comparisons of Indexes of Obstacles for Doing Business
(1 = no obstacle; 6= very strong obstacle)

Obstacle	World	MENA	DC	SSEA	LAC	SSA	EE
Financing	4.06	3.87	3.43	3.60	4.38	4.17	4.22
Labor Regulations	3.50	3.22	4.17	3.83	3.98	3.47	2.95
Foreign Currency Regulations	3.16	2.50	2.50	3.58	3.01	3.47	3.31
Tax Regulations	4.65	4.17	4.39	4.12	4.38	4.65	5.04
Policy Instability	3.68	3.54	2.55	3.32	4.22	3.63	4.15
Safety or Environmental Regulations	3.24	2.93	3.52	3.32	3.46	3.36	2.90
Inflation	3.83	3.51	2.50	3.87	4.02	4.30	3.95
General Uncertainty on Costs of Regulations	3.75	3.60	3.13	3.63	3.68	3.84	4.05
Crime and Theft	3.88	2.19	2.76	3.37	4.45	4.27	4.13
Terrorism	2.38	1.68	2.17	1.76	2.86	2.28	2.58
Inadequate Supply of Infrastructure	4.02	4.55	3.11	3.91	4.47	4.31	3.94
Corruption	4.21	4.27	2.76	3.64	4.70	4.67	4.35
Regulations for Starting new Operations	3.22	3.38	3.34	3.67	3.22	3.24	3.05
Price Controls	2.67	3.12	2.20	3.13	2.82	2.63	2.78
Regulations on Foreign Trade	3.45	3.78	2.67	3.54	3.64	3.57	3.61

Source: Brunetti, Aymo, Gegory Kisunko and Beatrice Weder "Institutional Obstacles for Doing Business: Data Description and Methodology of a Worldwide Private Sector Survey (used in the World Bank's 1997 World Development Report). Washington, D.C. World Bank.

Note: The MENA sample is rather small (109 firms) compared to 254 for Developed Countries (DC), 139 for South and Southeast Asian Countries (SSEA), 474 for Latin American and Caribbean Countries (LAC), 1288 for Sub-Sahara Africa (SSA), 1321 for Eastern Europe (EE) and 3685 for the world as a whole. The MENA sample was confined to three countries (Jordan, Morocco and the Palestinian territories of Gaza and the West Bank) believed to be among the most private business-friendly in the region.

Evidence in support of this point is provided in Tables A1 – A3 in the Appendix, which compare the scores of two well-known institutional indexes: the Fraser Institute's "Economic Freedom Rating" for 1975-1995 and the Heritage Foundation's "Index of Economic Freedom" for 1998. The ratings generally indicate that MENA countries face more severe restrictions than countries in other regions. However, because the deeper level of analysis provided by these two indexes allows us to gauge the relative severity of specific constraints, it is possible to observe that while some are much more cumbersome in the MENA region than in other regions, others are actually significantly less binding. MENA countries demonstrated greater restrictions for capital flows, restrictions on banks, wage and price controls, property rights, regulations, and black market (serving as a proxy for foreign exchange regulations). However, in terms of inflation, rights to have currency abroad, government transfers, the top marginal tax

rate, trade openness, and government consumption as a percentage of total consumption, many MENA countries have scores comparable to their non-MENA counterparts. The scores of several specific countries (Bahrain, Djibouti, Kuwait, and the UAE) indicate lower restrictions in the form of tax rates and trade protection.

Table 2 presents the average scores on each of the components of the "obstacle to business operations" scores from firms in the same three MENA countries used in Table 1 as well as those for the South and Southeast Asia (SSEA) and developed country (DC) samples. Clearly, even in this rather favorable sample of MENA countries, entrepreneurs are much more likely to feel disadvantaged with respect to the cost of doing business than their counterparts in the SSEA or DC samples. Indeed, 70 percent or more of sample MENA firms indicated that "unpredictability of the judiciary presents a major problem for my business operations" and that "it is never, seldom or only sometimes true that, in the case of changes in laws or policies affecting my business operation, the government takes into account concerns voiced either by me or my business association." These responses make it clear that businessmen in the MENA region feel that laws and regulations, and the processes of making, changing, enforcing and applying them, are quite unfavorable to successful business operations.[6]

Although they are not done systematically across countries, there are some single country surveys that give even more attention to the legal and administrative impediments to firms' competitiveness. For example, Lahouel's (1998) study of Tunisia found that 68 percent of the firms said that rigidity of administrative procedures represented a "fairly or very serious obstacle to their business." In Egypt, changes in production techniques or the introduction of new products were reported to require the submission of both establishment and operation licenses, which both requiring much time to obtain (Anderson and Martinez 1996). Kanaan (1998) reported the results of a survey of businessmen in Jordan in which 83 percent agreed that "bureaucratic impediments were very important obstacles to their business operations" and 68 percent agreed that "legislative and legal obstacles were very important." Included among

[6] Additional cross-country comparisons of institutional characteristics are available from foreign investors. One such widely cited source with good country coverage is the *Political Risk Yearbook*. Most MENA countries score just as badly (compared to the non-MENA countries) on the characteristics evaluated by foreign investors as on the above indicators developed from the responses of businessmen in general.

the latter were the multiplicity of laws, frequent changes in and amendments to these laws, and their inconsistent application.

Table 2. Comparisons of the Responses Concerning Obstacles to Business Operations by Private Firms from the MENA Region with those from South and Southeast Asia (SSEA) and Developed Countries (DCs)

Percentage of Firms Responding that:	MENA	SSEA	DC
Government never, seldom or only sometimes sticks to its policy pronouncements (lack of policy credibility).	30	11	30
Affected businesses are never, seldom or only sometimes informed about the process of developing new rules or policies.	63	42	44
It is never, seldom or only sometimes true that in the case of important changes in laws or policies affecting my business operation the government takes into account concerns voiced either by me or my business association.	73	48	63
They fear retroactive changes in regulations affecting their business operations.	56	37	23
Laws and policies have become more predictable (+) or less predictable (-) in the last ten years.	-0.08	+0.27	-0.13
Fear unconstitutional government changes accompanied by far-reaching policy surprises with significant impact on my business.	62	37	19
All in all, for doing business I perceive the state as an opponent.	12	0	9
It is always true that firms in my line of business have to pay some irregular payments to get things done.	12	7	1
Firms in my line of business seldom or never know in advance about how much this additional payment is.	52	42	58
Even if a firm has to make an additional payment, it **always** has to fear that it will be asked for more, e.g., by another official.	6	3	0
In the last ten years, difficulties in dealing with government officials have increased.	31	20	21
Have ever decided not to make a major investment because of problems relating with complying with government regulations.	46	29	35
The share of senior management's time spent on negotiating with officials about the changes and interpretations of laws and regulations exceeds 25%.	19	12	2
Rating overall perception of the efficiency of the customs services as good or very good.	12	10	38
Rating overall conditions of roads you use as good or very good.	21	21	48
Power outages occur more frequently than once every three months.	43	46	16
Taking less than 3 months to get a telephone line connected.	33	68	94
Rating the efficiency of the government in delivering services as efficient or very efficient.	4	31	23
Unpredictability of the judiciary presents a major problem for my business operations.	70	52	41

Source: Brunetti, Aymo, Gegory Kisunko and Beatrice Weder "Institutional Obstacles for Doing Business: Data Description and Methodology of a Worldwide Private Sector Survey (used in the World Bank's 1997 World Development Report). Washington, D.C. World Bank.

Note: The MENA sample is rather small (109 firms) compared to 254 for Developed Countries and 139 for South and Southeast Asian Countries and was confined to three countries (Jordan, Morocco and the Palestinian territories of Gaza and the West Bank) believed to be among the best in the region with respect to the environment for private business.

In an unusually detailed single-country study, Fawzy (1998) reports the results of a 1998 survey of Egyptian firms showing tax administration and commercial dispute settlement to be the two most severe constraints on their operations. Both such constraints, moreover, were reported to have increased in severity between 1994 (when a comparable survey had been undertaken) and 1998. Both obstacles were more serious on the domestic level than on the foreign level, for smaller firms than for larger firms, and for firms in industry, construction and

trade than for those in oil or tourism. In the case of tax administration, the problem is not the tax rates per se, but rather their application and administration by the tax authorities. Of particular concern are the arbitrariness in the determination of taxable profits by tax administrators and the inefficiency of dispute resolution. "The central problem… is that the criteria for tax assessment are ambiguous, and tax collectors enjoy unlimited discretionary powers" (Fawzy 1998, p. 20).

Similarly, in the case of dispute resolution, Fawzy showed the frequency and severity of disputes to be in the following declining order: bankruptcy, broken agreements, problems with the tax authority, and the quality of supplies. Almost two-thirds of the firms' disputes were with other private firms, 22 percent had disputes with government agencies, and the rest with banks, labor and public enterprises. "Apart from being time consuming, investors also complain that litigation is expensive and that the judicial system is not well acquainted with commercial disputes related to market economies" (Fawzy 1998, p. 22). She also reported their complaints about the lack of contract enforcement mechanisms and poor enforcement of laws. Such details on the problems related to dispute resolution are rare in the survey literature and thereby motivate further investigation of the costs of dispute resolution failures.

One of these costs, and one that is relatively well documented, is the long time it takes to resolve a dispute through the formal judicial system. Basing his argument on a World Bank survey that he applied to Egypt's commercial cases, Galal (1996) stated that the clearance rate of such cases taken to the formal court system was only 36 percent compared to 80 percent in Japan and 88 percent in Belgium. At the same time, the average time needed for the minority of cases that were settled had increased from two years in the 1970s to over six years in the early 1990s. Anderson and Martinez (1996) report times to completion of the average commercial case to be 2-2.5 years in Jordan and Lebanon, which again, are countries with among the best judicial systems and judges in the region. These time delays are not atypical of other developing countries, but are growing rapidly.[7] Naturally, the longer it takes to resolve cases and the lower the resolution rate, the higher are the firms' transaction costs.

Another important problem with the dispute resolution system is inconsistency in judicial outcomes. This is a very general problem. For example, The *World Development Report*

[7] For example, in 1993 it took 2.5 years to dispose of a case on average in Argentina, 1.9 years in Ecuador and 2.4 years in Venezuela. In all three of these countries, both backlog and median delays were increasing over time at rates ranging from about 15 percent to 30 percent per year, and were more serious for commercial cases than for civil ones (Buscaglia and Dakolias 1996).

disseminated the results of a survey of 3,600 firms in 69 countries which stated that more than 70 percent of those in the sample reported that an "unpredictable judiciary was a major problem." As noted above, various surveys in the MENA region have come to the same conclusion.

Still another problem in MENA countries and elsewhere is the perceived inequity or lack of equal access to dispute resolution systems. Small firms often feel disadvantaged relative to larger ones and poor households relative to rich ones. Such perceptions of inequity often show up in broader public opinion surveys of the effectiveness of the judiciary. Typically, these reveal even worse evaluations. For example, the results of a Gallup poll in Argentina in the 1990s showed that only 13 percent of the population considered the judiciary to be an effective institution (Buscaglia and Dakolias 1996). Where this is the case, naturally the respect for both law and legal institutions is likely to be weak.

III. Dispute Resolution Systems in the MENA Region and Transaction Costs

Given the high and increasing importance that businessmen in the MENA region attach to dispute resolution problems as constraints on their business operations, we turn now to a brief survey of historical trends in the character of dispute resolution systems and their implications for transaction costs and firm competitiveness.

Evolution of the MENA Region's Diverse Dispute Resolution Systems

MENA countries have inherited a very unusual mixture of traditional and modern approaches to dispute resolution. Generally speaking, informal and traditional dispute resolution systems were dominant until the mid-nineteenth century. Most disputes were settled at the local level by village heads, religious leaders or by councils of elders. In areas where economic activity was dominated by a particular commercial activity, these disputes were taken to an informal tribunal of peers. For example, in Bahrain where pearling (collecting pearls from oysters located on the Gulf's sea bottom by diving from ships) was the leading activity, there was a diving court that settled disputes with considerable efficiency.[8] Similarly, in the regional bazaars were "amins" who acted both as intermediaries between the modern system of dispute resolution and the informal network of producers (guilds). These amins mediated disputes between individual producers and their customers, on the one hand, and among individual producers, on the other. Clearly, these were times in which the informal system of dispute

[8] For details and references to such experience see Datta and Nugent (1991).

resolution dominated. Remnants of these traditional institutions are still in evidence in some rural areas and even in the bazaars, although they have been eclipsed by government institutions, trademarks and competition from outside the guilds.[9]

Due to the commercial success of producers in MENA countries in the period between the 8th and 12th centuries and the preference of foreign merchants to use the legal systems indigenous to MENA countries (largely Islamic) rather than their own, it would appear that at that time, the region's indigenous Islamic and other legal systems were perceived to offer advantages over foreign ones. Nevertheless, over the course of the following centuries, European legal systems gradually evolved so as to provide considerably greater flexibility for businesses than those prevailing in the MENA region. For example, corporations became legal entities and a body of law specific to them emerged in Europe that did not surface in the MENA region. By the mid-19th century, however, MENA elites became aware that their systems were comparatively unprogressive in these respects and began importing legal institutions from Europe.

This may have been one of the reasons why local leaders agreed to allow foreign merchants and citizens to be exempted from the domestic legal system in favor of foreign law (capitulations). Yet, the capitulations also greatly undermined the acceptance of western law by much of the region's population. In particular, it was perceived as imposed on them by foreign colonial powers. By exempting citizens of the colonial powers (who were very numerous by end of the nineteenth century) from taxes as well as prosecution in native or mixed national courts, the population indigenous to the MENA region perceived the justice system to have a dual standard, thereby undermining the legitimacy of both the modern formal system and international arbitration in the minds of most indigenous citizens of MENA countries.[10] While this did not occur in all parts of the region and was gradually eliminated in the 1920s and 1930s, the influence on both the respect for justice and the resentment of foreign intervention was very widespread.

A fresh start on modern court law was made in Turkey after World War I, in Egypt after World War II, and in many other countries of the region after their independence. The Egyptian civil law code of 1948 was modeled closely on the French civil code and, thanks to Egyptian law professors who helped construct the codes of other countries of the region, so too

[9] For an interesting description of the historical role of the amins and their marginalization in contemporary Tunis see Kuran (1989).

[10] For evidence and discussion of the capitulations, see Issawi (1982), El-Kosheri (1998). An analysis of the determinants of these capitulations and of the key elements of the relative decline of islamic law and its consequences for industrial development is provided by Kuran (2000).

were those of most other countries in the region. In recent years, Anglo-Saxon common law and the use of arbitration and other alternative dispute resolution methods (ADRs) have increasingly influenced Egypt and other countries in the region. This has been more noticeable in those parts of the region formerly under British influence such as Southern Yemen, Bahrain, the United Arab Emirates and Kuwait. Yet, the statist tradition in much of the region has generally limited the extent to which these newer developments have had an impact relative to other parts of the world.

Another impediment to the development of commercial dispute resolution systems in the MENA region has been the region's heavy reliance on public enterprise and hence on government regulations in support of these enterprises. It is not only difficult and extremely costly for private firms to challenge public enterprises, but most of these disputes have to go through administrative procedures rather than legal ones.

In principle, having a multiplicity of legal systems that include the traditional and Islamic systems, modern European civil law codes, and perhaps even some modern alternative dispute resolution systems (ADRs), could be beneficial. Such a system allows for greater flexibility and more choices. Yet, in some MENA countries the multiplicity has made for basic inconsistencies and lowered the predictability of outcomes. For example, in Yemen where the North had imported the Ottoman civil law system and the South had English common law, reunification of North and South in the 1990s has led to some severe inconsistencies in legal systems. Other disputes have resulted in several MENA countries where the governments prescribed the use of Islamic law despite the opposition of some commercial firms.

There is also ample evidence from the MENA region and virtually everywhere else that the demand for dispute resolution is growing extremely rapidly. Many factors lie behind these trends: commercialization, privatization, globalization, increasing competition among very large multinational enterprises around the globe, and perhaps also in the changing character of high-level managers and corporate lawyers (Dezalay and Garth 1996). In MENA countries, these rather universal trends are aided by growing frustration on the part of the private sector with ambiguous government regulations, the arbitrary way in which they are interpreted, and the absence of an effective judicial system for seeking redress.

Transaction Costs Resulting from Imperfect Dispute Resolution

Each of the various dispute resolution problems in the MENA region identified above raises the transaction costs of doing business in the region. For example, delays in resolving disputes raise the costs for all involved parties, in terms of both time and money. They also discourage

the disputing parties from making other possible contractual relationships both between each other and with other actual or potential contractual partners. Inconsistencies in the outcomes of resolution lower the incentive to reach out-of-court settlements to such disputes for at least one of the parties, reinforcing delays and distorting managerial decisions. Inconsistent outcomes, moreover, can increase risk and uncertainty for investors and hence lower investment and growth. Perceived inequities in the outcomes of the dispute resolution systems undermine respect for the system in general, including law and order, quite possibly encouraging individuals and firms to act outside the law. They also contribute to underdevelopment of the law itself, leaving firms with fewer options for solving their problems. To the extent that loose law enforcement prevents contracts from being enforced, it also gives the contracted parties incentives to under-supply effort, lower product quality and to renege on payments.

To the extent that property rights are undermined by these shortcomings, a variety of additional transaction costs may be added. Where the property rights laws or their enforcement are vague and incomplete, the true owners of any product, service or resource cannot easily be identified. If so, any potential buyer has less incentive to buy a particular product since, by doing so, he might not gain legal ownership or possession. This may cause the seller to settle for a lower than expected price, or even not to try to sell it. At the same time, when the veracity of a seller's right of ownership is in question, the potential buyer may have to incur higher information and/or transaction costs in order to determine the authenticity of ownership. Even if the seller is the true owner of the item, if such costs are sufficiently high, the fear that he may not be the true owner may discourage the buyer's willingness to purchase. If the transaction is undertaken but the seller's claim of ownership should turn out to be false, there may be additional costs to the buyer, e.g., to get the seller to return his payment or to protect it from the true owner or anyone else who may try to take the item away from him. Incomplete or ambiguous property rights can also reduce the incentive for investment and hence growth. Without clear property rights, any property possessed will be less useful as collateral, reducing credit availability, again discouraging investment and growth. Moreover, to the extent that these shortcomings in the system discourage new entrants and competition and reinforce existing inequality, they may worsen income distribution and, because of the likely positive relationship between equity and growth, can further retard growth and development. Each of these effects raises the costs of doing business both absolutely and relative to both what these costs are elsewhere and what they could be under ideal circumstances. In the case of weak intellectual property rights, there will be insufficient incentive to innovate and hence the rate of technological change can be reduced.

The higher such costs become, the more that suppliers will attempt to pass these costs on to their customers by increasing their selling prices. Even worse, in many cases, this may raise the price to such an extent that transactions do not take place, causing producers to exit from the industry or in other cases to prevent firms from entering the industry. More commonly, the higher transaction costs derived from lengthy and ill-managed dispute resolution systems have the effect of increasing the degree of vertical integration, thereby undermining specialization and the technological benefits thereof and decreasing the competitiveness and flexibility of the economy. The high costs of dispute resolution and other institutional failures, therefore, can constitute a very plausible explanation for the paradox of how, if capital is so scarce in developing countries, the rate of investment (including foreign investment) can be so low.

IV. Alternative Means of Reducing the Costs of Resolving Disputes

There are three general means of reducing the costs of dispute resolution. One is to clarify and/or streamline laws and regulations in order to reduce ambiguity and the potential for conflict. This involves *legal reform*. The second is by improving the process and functioning of the judicial system, i.e., by *judicial reform*. The third is by strengthening *informal or alternative* dispute resolution systems (*ADRs*).

As the following review of these three strategies indicates, there is no universal best way of reducing the transaction costs arising from such conflicts. Each general approach has several variants and for each variant and approach, there are advantages and disadvantages. Since countries, regions and sectors of economic activity vary in their culture, behavioral norms, environmental conditions, sources of conflict and social and economic objectives, all such considerations have to be given careful consideration in choosing how best to reduce this important and development-retarding source of high transaction costs. Attempts at reform are bound to face strong resistance from those vested interests that see advantages in preserving the status quo. Moreover, since many reforms are complicated and have a long gestation period, careful assessments of the effectiveness of different dispute resolution reform strategies are difficult to accomplish, and for this reason rare. Nevertheless, wherever possible, in identifying the main alternatives within each such approach in the following sections, attempts are made to identify examples of best practice.

Reforming the Formal System through Legal Reform

Given that laws and regulations frequently arise from compromises (often behind closed doors) among groups with different backgrounds, objectives and points of views, and are crafted with considerable uncertainty about the likely effects, laws are often not clearly written. Many such

laws, moreover, are likely to have originated from a much earlier in time, making them difficult to understand and limiting their relevance and effectiveness in the contemporary period.

The degree of ambiguity and lack of knowledge concerning relevant laws is increased by both the frequency of issuance of new laws by the legislature and binding presidential or other by the executive branch, and inconsistencies between some of these laws and the way they are enforced. Such problems are more severe when the process and debate leading to these laws is as non-transparent as in the MENA region (section II above) and firms feel excluded from the process. Worse still, the new laws are often published only with a considerable time lag or sometimes never published at all. All these factors increase the likelihood that most citizens and firms will lack familiarity with existing laws and regulations. Even when the laws might be known, the monitoring and enforcement of these laws may be done by several different agencies, each with different methods and criteria in application. As a result, there can easily be substantial differences between actual practice and the method prescribed by law, and individual and firms may be uninformed about one or the other or both.

Whatever the source of such ambiguities in laws or regulations, they are likely to give rise to conflicts among private parties because each party will have an incentive to interpret the law in a way favorable to its own interests. As a result, many essentially avoidable conflicts will end up in formal courts, tying up scarce legal personnel and court time that could be more usefully devoted to other issues.

What can be done to reduce these ambiguities and thereby reduce the costs of dispute resolution?

Property Rights Laws

One such means is by defining or clarifying property rights by rewriting particular laws. Incompleteness or ambiguity in property rights can arise from many sources, such as the absence of a written document of ownership or lack of clarity in the location of the property, the character of the rights (use rights, sale rights, bequeathal rights, rental rights, etc.) and the manner of their enforcement. Hence, laws defining very clearly the scope of such rights and how they are to be enforced can help to remove such ambiguities and an important source of dispute resolution costs. Also needed is a clear demarcation rule concerning the amount of time that needs to go by before someone's claim can be considered legitimate (the law of adverse possession). Without irrefutable proof of ownership in the form of clearly specified rights, there is always the chance that someone with a stronger claim of ownership will subsequently

appear. If the time allowed is too long, productive investments by the possessor may be discouraged in the meantime, or alternatively made but wasted. On the other hand, if it is too short, the true owner's right of ownership may be compromised and absentee owners may be discouraged from making investments on their property.

Other problems have to do with the vagueness of the rights conferred. One source of vagueness may derive from the regulatory powers of local or other governments. These need to be made as clear and clearly limited as possible. Since one of the benefits of clearly defined private property rights is the usefulness of such property as collateral, there should be a simple, accessible means of registration of titles to property and qualifying property as collateral. Titling has often been associated with property grabbing by elites with much better access to titled property than the poor. When this occurs, respect for private property and the law will be undermined. For this reason, titling legislation should make the means of doing so as transparent and accessible to the poor and small enterprises as possible.

Different forms of property may need special clarification, standardization of terminology and regulation. For example, in the case of land, the land needs to be surveyed and clear, generally recognized, boundaries defined. Conflicts and inconsistencies among laws of different levels of government should be avoided, e.g., by giving local governments exclusive rights. While many land titling programs have not been very successful and others are too new to evaluate, some especially well-documented cases should be noted. One such case is that of Costa Rica in the 1830s and 1940s. As described in Nugent and Robinson (1999), the Costa Rican success was characterized by local governments that were competing with each other to attract settlers. Using the provision of land and titles as incentives, the government was able to develop a long-gestation crop (coffee) early on and along with it, a credit system based upon titled land as collateral which, in turn, helped foster the development of banks, technological change, education, productivity growth and perhaps even democracy. Another much-studied case is that of Thailand in the early 1980s. Although this program was more limited in its extent and may have been more biased toward more well-established and wealthier farmers, the titled plots were rather small in size (as in the Costa Rican case) and thus much more egalitarian than in other cases. Numerous studies have demonstrated the effectiveness of titles in increasing the access to credit and hence also the productivity and investment of farmers possessing such titles relative to those without titles.[11]

[11] See Feder and Onchan (1987, 1989) and Feder, Onchan, Chalamwong and Hongladarom (1988). The exclusive role of the local government and transparency of the titling system have generally not been adhered to in Brazil, perhaps responsible for the much weaker results (Alston, Libecap and Schneider).

What were some of the ingredients of these successful cases? One factor was that they were done at times when land was becoming increasingly scarce. Another was the low costs and transparent processes used at the local level. Third, the processes were accomplished gradually over a decade or more so as to assure adequate administration and monitoring. Titles were also made mandatory for proving property rights.

The means of protecting industrial property rights are likely to be quite different. In the case of equity shares of enterprises, it is important that the rights of minority owners be clearly specified and given special protection through detailed provisions of the law. Otherwise, minority shareholders will have little incentive to buy shares in private firms and equity markets will remain absent or underdeveloped. How can this be done? Some ways include amending law provisions making it easier for such stockholders to call and attend meetings of the board of directors, to exercise their votes (e.g., by absentee ballots), and to require independent audits.[12]

As MENA countries move up the technology ladder and attempt to attract environmentally clean industries like computer software development and information technology, the extension of property rights legislation to intellectual property rights may become increasingly necessary. One important way to do this is by signing onto the Treaty on Intellectual Property Rights (TRIPS) and/or by modifying patent laws in ways suitable for such industries and activities. Especially where speed of action is essential to enforcement, claims of infringements of property rights (e.g., of trademarks and licenses) must be handled expeditiously.[13] In other words, legal reform should be tied to clear, well-functioning judicial enforcement.

Bankruptcy Laws

Another area of legal reform with scope for reducing the costs of dispute resolution is bankruptcy law. Generally speaking, MENA countries are believed to be very deficient in bankruptcy law, implying that there is very considerable potential for reducing the costs of

[12] La Porta Lopez-de-Silanes, Schleifer and Vishny (1998) use quantitative indicators of various aspects of creditor and investor rights and their enforcement from a sample of 49 countries of different legal traditions to show that these indicators are significantly lower for the civil law countries that do not have such provisions than for the common law countries that have them. Three MENA countries (Egypt, Jordan and Turkey) were included in the sample of civil law countries. They also showed that shareholdings were less dispersed and more highly concentrated in the countries of the French civil law tradition than in the other countries. In a parallel study of bank sources of finance, Levine (1999) shows that financial intermediaries are also less developed in the countries of the civil law tradition because of their weaker protection of creditors. He also shows that, once one controls for these individual legal provisions, there is no longer any significant difference in the concentration/dispersion of shareholders between civil law and common law countries. Hence, if MENA countries were to adopt creditor and investor-friendly laws and enforce them, they would be at no disadvantage relative to common law countries.

[13] See, e.g., Al Tamimi (1995).

dispute resolution through appropriate changes in bankruptcy laws. In the absence of any legally established bankruptcy procedure, a creditor may not have the right to seize the assets that the debtor has put up as collateral. Similarly, in the absence of collateral, he may not have the right to petition a court to sell some of the debtor's assets to cover the debt. If the creditor cannot obtain repayment of the loans provided, he will either refrain from lending or pass on his losses in the form of higher interest rates to non-defaulters, or both. In either case, this raises the costs of credit to firms in general, thereby reducing their competitiveness.

Even if a country does have bankruptcy laws, they can give rise to disputes, delays and inefficiencies if they are not clear. For example, it is important for the law to specify exactly how soon after an apparent default on a debt an action to claim assets of the bankrupt firm can be taken, what kind of assets can be used as collateral, and when and how the motion to the court can be made and the response obtained. If there are multiple creditors, the order of priority among the creditors must be specified or recognized by the law to avoid unnecessary conflicts and delay. At a minimum, the law should establish an orderly bankruptcy procedure when none is specified in the contractual relationship.

Most bankruptcy procedures involve several steps. First, an individual, firm, or bank to which a debt is owed petitions a court or government agency to put a lien on the assets of the alleged defaulter. Second, the authenticity of the creditor's claim is investigated. Third, if the claim is verified, an investigation is made into the most appropriate means of resolving the problem. The options range from outright liquidation of the defaulter's assets (and using the proceeds to at least partially compensate the creditors in a designated order of priority) to leaving the defaulter's assets in tact but restructuring the firm so as to return it to viability. Finally, the decision on liquidation or restructuring is implemented (in the case of liquidation, perhaps the liquidation of collateral will be implemented as well), and the creditors receive at least partial compensation. Even under the best of circumstances, these steps may take time, more so if any of these steps is clouded by ambiguity in the law or its enforcement.

What would make for an effective bankruptcy procedure? In particular, it should be designed in such a way as to satisfy certain desirable objectives. First, the decision of what to do with the firm should be based on maximization of the total value of the assets. Second, these assets should be divided between the debtor and the creditors (and possibly other parties such as workers or the government) in such a way as to penalize managers and shareholders of the

bankrupt firm. Third, it should establish a rational order of priorities among the claimants.[14] In the latter, it is important that shareholders not be entirely neglected. Such an action would give them and their managers an incentive to undertake highly risky actions that may minimize the probability of bankruptcy – but at the cost of lower expected returns and higher probability of large losses.

If capital markets were perfect, information complete and rapidly communicated, and the firm worth more as a functioning enterprise than an inactive one, then it would be appropriate to resolve the situation through a competitive auction of the firm as a whole. However, if these conditions are not satisfied (as seems likely), the law should require a structured bargaining procedure. In establishing such a procedure, care should be taken to avoid mixing together the decision of what to do with the firm and that of identifying priorities among the creditors. Doing so could complicate the bargaining and lead to large delays. Restructuring, however, should not give creditors and shareholders perverse incentives that could lead them to a wrong decision about the firm's future.

How might this be avoided? A modified version of a proposal by Hart (1999) might be considered. In particular, once bankruptcy is demonstrated, an automatic debt-equity swap (with the amount of equity going to each creditor predetermined) could be carried out, thereby removing that issue from bargaining and making shareholders out of all the parties.[15] This would give all parties the incentive to make the best decision about what to do with the firm. The new stockholders could elect a new board of directors who then could decide by majority vote what to do and how to do it, thereby also minimizing reliance on the already overcrowded courts to solve the problem.[16] Clearly, such a procedure would provide more flexibility in the restructuring process than most existing schemes. Hence, a good bankruptcy procedure could be achieved with a much lower transaction cost and court time than in the Chapter 11 type of bankruptcy procedure used in the U.S. and elsewhere.

Other desirable features of a bankruptcy law might be dictating a means of mediating disputes if none exists in the contractual relationship and providing a framework for restructuring if experience in such is limited. Such a framework would be especially important if the aforementioned automatic debt-equity swap procedure is unavailable and previous experience in restructuring is limited. But what is mandated should be confined to process

[14] For example, it could put secured lenders first, in the order in which they provided credit, then unsecured lenders (again in order of their loans), and finally shareholders (perhaps again prioritized by type).

[15] In a context where workers rights as stakeholders are believed to be fundamental to any socially desirable solution, they too could be included in this process.

[16] Rowat and Astigarraga (1999) provide examples from Latin America of excessive rigidity even in some of the procedures introduced under judicial reform.

since in general the parties themselves will be in a better position to select the best substantive solution. The smaller is the extent of previous experience with restructuring more narrowly defined the procedure should be. As far as substance is concerned, experience has shown that it is better to keep the agreement voluntary rather than mandated, though it may generally be useful to supply the parties with a menu of best practice alternatives. Both Thailand's 1998 bankruptcy law reforms and Indonesia's come close to this prescription with the exception that they didn't provide the automatic debt-equity swap at the beginning. Something of an exception should be made for a country like Korea, in which the government enjoys great credibility for making objective and efficient decisions about what to do with the bankrupt firm and other matters.[17]

Because current bankruptcy law and practice in MENA countries is far from optimal, there may well be a tendency to suggest radical change. Yet, the larger the deviation of legal prescription from current practice, the greater is the likelihood that the legal prescription will not be converted into actual practice unless the government brings strong sanctions to bear on the different parties involved. Since reliance on government to use such powers is likely to introduce numerous additional problems, there is a case to be made for avoiding radical change, instead codifying some of the best of existing practice in the country.

Using the Peruvian experience, de Soto (1989) suggested that dispute resolution and firm transaction costs could both be reduced through legal and administrative reform, in particular, by removing or at least reducing unnecessary regulations imposed by laws and decrees. Such an approach may be especially desirable in those circumstances where the cost burden of such regulations is high due to the proliferation of regulations and laws. In such cases, economic activity may be pushed underground into the informal sector or altogether eliminated, in either case at great cost to the society.

The lesson of such an experience is that each country should carefully and periodically go through its existing regulations and remove all those that are irrelevant, conflicting with others, and inefficient in terms of benefits and costs. Regulations should be pruned down to those that matter to the welfare of society, and then these should be made as clear and transparent as possible. By eliminating the inconsistent and irrelevant or redundant regulations, it can become considerably easier for those regulated to identify the relevant regulations. Otherwise, they are likely to be ignorant of them. There are good reasons for some regulations. However, for many

[17]Since the Korean government enjoys a much better reputation in this respect than Indonesia, this may explain why giving the government mandatory powers to arrive at a substantive solution might well be "best practice" for Korea, whereas prohibiting government from assuming such powers and thereby keeping the program strictly voluntary may be best practice for countries like Indonesia (Gitlin and Watkins 2000).

others the costs outweigh the benefits, which suggests they should be removed or modified. For example, Galal (1996), Bechri (1999), and Lahouel (1998) suggest that regulations over prices and labor markets should be candidates for removal or substantial reduction since they greatly reduce the ability of firms to adjust to changing circumstances and to remain viable in the face of bad times. They may also contribute to the high rates of unemployment that characterize many of these countries.

The regulations that would be retained, moreover, should be purged of ambiguities since they increase the vulnerability of such regulations to arbitrary and unequal treatment by administrative authorities. Such circumstances give rise to corruption. One example of this is tax regulation, which (as noted above in 1998) was regarded by Egyptian businessmen as the most important constraint on their business activities. Since any tax authority may have an incentive to overcharge and may be subject to political pressures, both the likelihood of disputes and corruption arising from any given regulation can be reduced by making the rules as transparent as possible, limiting the responsibility for their enforcement to a single agency, and allowing for appeal to an easily accessible independent appeal agency.

Reforming the Formal System through Judicial Reform

As has been demonstrated by many failed attempts to improve the economy by simply rewriting laws, legal reform is unlikely to be sufficient in itself. Good laws are worthless unless they are properly enforced. Proper enforcement, in turn, requires legal procedures that are clear, efficient, and deemed fair in allowing equal access and outcomes to citizens and firms of different types, and qualified and properly motivated personnel to carry out these procedures. Hence, for each of the above types of legal reforms, procedural reforms or reforms to the judicial system may also be required.

In particular, even the best of property rights law will not really protect property rights if the procedures for their enforcement are too ambiguous, time consuming and uncertain in outcome. Indeed, insufficient enforcement can be another important source of market failure and lack of development. Since rental markets are an important means for the landless poor or small enterprises to gain access to land and equipment, the failure to enforce rental contracts can harm both equity and the allocative efficiency.

In choosing the best way of accomplishing judicial reform, four important objectives should be considered. These are: (1) to limit the arbitrary power of the legislative and executive branches of government, thereby making government operate within the rule of law; (2) to increase the speed and efficiency of the judicial system; (3) to increase the consistency

(or predictability) of judicial decisions; and (4) to improve access to the system. Each of these objectives can be approached in different ways.

The first of these objectives would seem of special importance in the state sector-dominated MENA region and may be the most difficult to accomplish since it requires establishing judicial independence. Only with judicial independence can private entrepreneurs and their investments be protected from the changing and arbitrary whims of partisan politicians and government commitments to the private sector be deemed credible.[18] How can judicial independence be achieved? One such means is to place the judiciary's budget out of the reach of other branches of government. Another is to sharply limit the powers of members of the legislative and executive branches over the appointment, evaluation and punishment-reward system of members of the judiciary. Still another strategy is to increase the education and training requirements of members of the judiciary and to strengthen its internal esprit de corps. However, since judicial independence may not protect citizens and firms from the judiciary itself, there still may be need for external monitoring of the judiciary. The legislative or executive branches of government, however, should certainly not act as the exclusive or even primary monitoring agencies.

The case of El Salvador since the mid-1980s constitutes an excellent example of how judicial independence can be accomplished. Prior to that period, before the peace accords brought the country's long civil war to an end, El Salvador's judiciary was extremely politicized. Thus, the Supreme Court changed with each change in government and every member of the judiciary was appointed by political criteria rather than judicial competence. The judiciary was almost universally seen as corrupt and unfair, and as carrying out the will of the political elites. What was done to change this?

First, the judiciary's budget was taken out of the general budget managed on by the executive and legislative branches. Instead, its budget was set by law at 6 percent of total government receipts. Second, the power of the national assembly and executive over judicial appointments and monitoring was greatly reduced by introducing a national judicial council dominated by members elected by law faculties and law associations. The council, rather than the government, was given the responsibility to identify a ranked list of candidates to send to the assembly for selection. Third, the government's influence was further weakened by regularizing the terms of judges and that of any single political group or party by requiring a two-thirds vote of assembly members for some of the judges rather than only a simple

[18] See North (1990), Williamson (1995), Levy and Spiller (1993), Trebilcock (1997), Brunetti and Weder (1997) and Henisz and Zelner (1999).

majority. Fourth, the council became the monitoring agency in charge of training, evaluating and applying incentives to members of the judiciary. Fifth, through major improvements in training and supervision, the quality and esprit de corps of the judiciary was improved. According the Inter-American Bank (1999), there is already considerable consensus that judicial independence measures have greatly improved both the efficiency and equity of the judicial system.[19]

Similarly, the speed and efficiency objective can be accomplished in several ways, such as by streamlining judicial procedures, improving the information-storing and retrieval capabilities of the judiciary, providing the judiciary with management training, lengthening the (often short) workweek of the judiciary, stripping judges of their non-judicial functions (such as administration and book-keeping), discouraging frivolous suits that can clog up court calendars and hence "crowd out" more socially important cases,[20] substituting simple, substantively and procedurally efficient "rules" that can be easily monitored for violations, for more multidimensional "standards" in laws,[21] and increasing the degree of specialization in judicial responsibilities[22].

The third objective of achieving consistency in decisions can also be achieved in a number of ways. One such way is by creating specialized courts, i.e., courts for small claims, bankruptcy, family disputes, property theft, commercial contract violations, etc. A complementary means is by training judges in very specialized fields, and by having them reviewed and evaluated by peers in the same specialization. Still another means is to increase use of precedent, either by use of the common law (as in Anglo-Saxon countries) in which precedent plays a large role[23] or codification of existing commercial norms and social norms encouraging efficient forms of cooperation (Cooter 1996). By increasing consistency in decisions, uncertainties about judicial outcomes can be reduced and, along with them, the costs of litigation, corruption and barriers to contractual relations. In the process, respect for the law can also be increased.

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[19] For example, cases that were taking 2.5-3 years to resolve prior to reform were taking an average of only four months after the reform. For a somewhat less positive evaluation of the Salvadoran experience see Popkin (2000).

[20] This could be accomplished by a rule requiring all such disputes to be submitted to binding arbitration.

[21] A rule is substantively efficient if it internalizes an externality and procedurally efficient if it reduces the cost or increases the accuracy of using the legal system. One example of a rule that satisfies both characteristics is one that forbids the use of another person's property without consent. The validity of any claim of violation of A's property by B is simple and objective as it boils down to whether or not (1) the property belonged to A, (2) was used by B, and (3) whether B's use was without the consent of A. Another example is limiting claims of property rights infringement to those made within a certain specified time (Posner 1998).

[22] This is because research has shown that the time for resolving cases is shortened by specialization. In particular, the judge has less need to do legal research (Buscaglia and Dakolias (1996).

[23] Mahoney (1999) shows that common law countries enjoyed growth rates of per capita income that were about 1% per annum above those of civil law countries. Posner (1998) provides examples of useful codification.

The last of the four objectives, that of improving access to the formal legal system, is perhaps the most essential. Even if a country has the best constitution, the most unambiguous laws, and the most effective system of specialized courts, they all will be of little use if the costs of using them are prohibitively high. For the judicial system to be respected as "fair", access to it must not be limited to the privileged insiders, the rich or the government. Having courts that specialize in small claims or in issues of special relevance to small firms can help in this regard, as can other measures that increase the efficiency and speed of the judicial system. If (as in Egypt) the revenues from commercial law courts are used to cross-subsidize criminal courts, access to commercial cases can be improved by simply removing the cross-subsidy component of the fees (Giugale and Mobarak 1996). Consideration should also be given to subsidizing small firms' and the poor's access to the formal system.

While the costs of various means of achieving these reforms may be relatively easy to measure, the benefits are likely to prove more difficult to estimate. Notably, however, the World Bank has been trying to quantify judicial outputs more effectively, e.g., by measuring the quality of judicial outcomes, weighting the quantity of judicial decisions by their quality, and adjusting for the complexity of the cases.[24] Another means of identifying benefits is to ask the entrepreneurs themselves how much their trade, investment or other activities would increase if the formal judiciary were improved.[25] Still another is to (1) construct a proxy measure of the efficiency of the judicial system at the aggregate (country) level, and (2) to relate the variation in such a measure across countries to the variation in income levels or alternatively to variations in income growth rates across countries.[26] Finally, another approach is to evaluate trends in the resulting hedonic pricing method. For example, in Brazil, it is estimated that, after controlling for quality and other characteristics, apartment rental rates are some 20 percent higher in those cities and towns in which the courts are especially slow in processing evictions relative to those cities and towns where evictions can be obtained quickly.

While comparable benefit-cost calculations that gauge these various mechanisms' ability to improve the effectiveness of the formal judicial system are seldom available, several general

[24] See for example, Buscaglia, Dakolias and Ratliff (1995) and Dakolias (2000). Such calculations are being carried out for a small number of countries over time, thereby identifying the need for judicial reform and assessing the impacts of various reform measures in such countries. Unfortunately, at present there is no MENA country in the sample.

[25] One example of this approach is a survey of Brazilian entrepreneurs reported by Castelar Pinheiro (1998). On average, surveyed entrepreneurs said that their investments would be 10 percent higher if the performance of the Brazilian judiciary were raised to that of more developed countries.

[26] For some examples of this approach see Knack and Keefer (1995), Mauro (1995) and Barro (1997). Sherwood et al (1994) estimate that economic reforms may have 15 percent greater effect on growth when the country has a relatively strong judicial system.

conclusions can be drawn. First, throwing more money at the judiciary is not in itself a solution.[27] Second, as the complexity of the issues involved increases, so do the judicial costs, thereby decreasing most conventional measures of efficiency. Some factors lying behind such complexity are difficult to treat, such as the number of parties to the contracts, their heterogeneity, and technological issues. Other sources of complexity, however, are avoidable, e.g., by reducing the ambiguities and/or inconsistencies in existing laws or reducing the number of resolution-delaying legal maneuvers that are possible when the lawyers are paid by the court and compensated by time spent on the case. Since poverty of the plaintiff often contributes to delays by giving defendants an incentive to delay, a case can be made for providing legal assistance to poor plaintiffs.

While these conclusions may be excessively general, the potential for substantial cost savings through judicial reform can be detected by a judicial survey.[28]

Developing and Encouraging the Use of Alternative Means of Dispute Resolution (ADRs)

The last alternative means of lowering the costs of dispute resolution is through the strengthening of so-called "alternative dispute resolution" measures (ADRs). ADRs are of two general types, traditional and modern. The former is often characterized by dispute avoidance (before the fact) as opposed to dispute resolution (after the fact). Under the right circumstances, however, both may be lower in cost than more formal means of dispute resolution, and for this reason, should be encouraged.

Traditional Informal Mechanisms and Their Advantages

There are two special features of traditional ADRs that tend to reduce costs, namely, their greater reliance on: (1) reputation (by selecting parties to contracts who are more reliable and less prone to wind up with disputes) and (2) mediation and arbitration procedures that may limit the scope of conflicts and resolve them more quickly and amicably.

The advantages of traditional ADRs are likely to be especially strong in relatively simple societies, well-endowed with trust, "social capital" and other social norms that encourage people and firms to fulfill their contractual and other obligations. In such contexts, each has an incentive to establish a good reputation for being a reliable contractual partner or member of a

[27] For example, Buscaglia and Dakolias (1996) showed that, at least among Latin American countries, there is no correlation between judicial compensation or judiciary budgets and judicial performance.

[28] One such example is the survey of Thailand's bankruptcy procedure summarized by Foley (1999). Each step in that process tended to be the responsibility of a different judge and any single step not completed on an assigned day might well be interrupted for weeks or even months because of the need to reschedule and then sent to a different judge. In the absence of a specialized bankruptcy court, moreover, each new judge assigned to the case had to receive specialized training. Under such circumstances, it is easy to suggest that judicial reforms could be useful.

mutual insurance society. Informal networks can also be used to support multi-party or collective enforcement mechanisms. For example, the penalty that may be exerted on a trader who defaults on payment to a producer without going to court may be considerably greater when many producers boycott that trader than when only the original producer does (Greif 1996). Another characteristic of such societies is the existence of social norms underpinning the desire for reputation, cooperation and collective enforcement. Sometimes these norms can be so well embedded in the society as to be internalized. In this case, because all parties may feel sufficiently badly if they were to violate this norm, they would simply never do so. Naturally, this can greatly reduce the need for legal penalties and hence also the need for a formal judicial system (Granovetter 1985).

The maintenance of informal systems, however, is not necessarily cost-less. Indeed, the gift-exchanges, the costs of hospitality, the provision of help when needed in such a setting and the maintenance of informational networks in the face of modernizing influences can all be quite costly. Moreover, the usefulness of these mechanisms for dealing with contractual relations and dispute avoidance may be subject to rapidly diminishing returns as distance increases. Furthermore, while these norms and collective enforcement mechanisms may reduce transaction costs and increase exchanges among members within groups, they may actually discourage interactions between separate groups.

A device suitable for reducing the likelihood of disputes in more modern societies is the credit bureau. The credit bureau aims to mimic the role of the village network. It collects information on the reliability and reputation (e.g., credit-worthiness) of potential contractual partners and then makes this information available to those parties looking for contractual partners (Klein 1992). A problem, however, is that the creation of the credit bureau is subject to free-riding.

Modern Forms of ADR

In urban areas of modern societies where such institutions are often no longer functional, there may exist professional mediators and arbitrators. Some services of these kinds are provided by governments, often local government; others by NGOs, including professional associations and international arbitration centers; and others by private individuals or firms. These ADRs take an ever-increasing number of forms, such as dispute review boards, contract administrators, partnering, dispute resolution advisors, negotiation, mediation, expert determination, and a large variety of arbitration methods.

Despite that in modern settings these methods may not have the informational and stability-of- norm advantages of traditional settings, virtually all these forms of ADR are still likely to have several important advantages over the more formal methods. With fewer agents involved and with simpler procedures than formal courts, they are very likely to be faster. Thus, Being faster and having less complicated procedures, the informal mechanisms of dispute resolution are also likely to be considerably cheaper. Since the choice of mediator or arbitrator is that of the parties themselves, they can choose experts with considerable training and experience in the subject matter of the dispute, thereby avoiding the time required to educate the judge and possibly a jury on the relevant legal issues. As private processes, mediation and arbitration can provide greater privacy concerning the nature of the conflict than going through public courts (which work best when they are open). Since these forms of ADR are more completely under the control of the disputing parties, these parties are less likely to complain that the process is out of control and on a path determined largely by lawyers and formal court procedures. As an essentially private process (in contrast to a judicial system), the private and social costs are likely to be much closer (if not identical) than in the case of litigation, where the social costs generally exceed the private costs and thereby suggest that litigation in the formal system is likely to be excessive.[29]

When one of the parties to the dispute is foreign, another advantage (for that party at least) is obtained when the procedure is taken out of the courts of the other party's country in which the domestic party may be seen to have an "unfair" advantage. Last but not least, because they are far less confrontational than the suits and counter-suits of formal legal systems, such ADRs increase the likelihood that profitable contractual or other relationships between the disputing parties can be reinstated once the dispute is resolved.

Of course, there are also disadvantages of these more informal legal mechanisms relative to formal ones. In particular, since ADRs are done with the consent of the parties involved, there can be delays in getting one of the parties to agree to commence the process. For the same reason, each conflict resolution is extremely case- and party-specific, making consistency among similar kinds of cases less likely. Another disadvantage, especially in cases where the courts are not involved, is that the decisions may be non-binding, especially when the ADR takes place outside the country. Hence, eventually, if one of the parties defaults on the agreement or decision, the other may have to resort to formal legal action even after having had a decision reached by the ADR. If so, any cost advantage of having used the ADRs rather than

[29] See Shavell (1982) and Kaplow (1986).

the formal system may disappear. The comparative advantage and cost savings of ADRs also tend to decline sharply as the number of parties involved increases.[30] Since such procedures are much more common in developed countries, skilled personnel to carry out ADRs may be in short supply in some developing countries. Finally, some forms of ADRs may be of little use in cases involving government.

These disadvantages, however, can be overcome in various ways. For example, their non-binding character can be overcome by formal laws decreeing them to be legally binding and enforceable in court. Enforceability can also be enhanced when the judge himself serves as a mediator or makes a decision that the case must be taken to another mediator or arbitration court. Such procedures are allowed for under the civil codes of many countries.[31] Potential lack of consistency can be overcome by establishing a common framework for the particular form of ADR in a certain industry or country and encouraging the local development of a corps of professionals with similar training and experience. The lack of enforcement of an ADR conducted outside the country can be overcome if the host country signs the United Nations Convention on the Recognition and Enforcement of Foreign Arbital Awards of 1958 (more popularly known as the "New York Convention"). This convention automatically makes foreign arbitral awards locally enforceable.[32] If a country's sense of sovereignty is threatened by using arbitration centers outside the country, the "foreignness" of international arbitration proceedings can be reduced if the country has a sufficiently satisfactory legal framework for arbitration and the quality and quantity of infrastructure to encourage the establishment of an International Arbitration Center in the country.

For each such means of "compensating for" the weaknesses of ADRs, however, there are also disadvantages. Hence, trade-offs have to be evaluated. For example, whenever the formal system is to enforce or otherwise get involved with an ADR, it is likely to impose some more formal procedures on them, such as that any agreements reached are put in writing and that the agreement be preceded by another agreement to arbitrate (or mediate). Formal courts may also limit the types of disputes which can be settled through ADRs, set guidelines for the eligibility of persons to serve as arbitrators or mediators, and allow appeals of ADR agreements to the

[30] This problem could be made less severe if provisions were made for a means of consolidating the different proceedings among different subsets of the parties involved.

[31] Because most parties to ADRs abide by their agreements, enforcement by the formal system has rarely been tested, leaving doubts as to whether they would be if such enforcement was formally requested. Hornick (1991), for example, cites that a request for such enforcement had been made in East Java, Indonesia but had not been acted upon at least within the following two years.

[32] Quite naturally, the internationally based arbitration procedures used for example in disputes involving large foreign enterprises are more formal in nature and have procedures similar to the formal legal systems of the most highly developed countries, implying that the procedures may no longer be very inexpensive.

formal system. Frequently, such interfaces with the formal system will slow down the resolution process. The lack of skilled personnel to manage ADRs domestically can be overcome through the use of incentives promoting their supply but may require either the use of foreigners or underwriting the costs of training nationals.

Other choices to be made concerning the exact form of ADR to be used in arriving at the optimal tradeoffs include whether the specific form of ADRs should be contract-mandated or strictly voluntary, whether or not the decisions arrived at should be considered legally binding, how early in the contractual relationship the ADR technique should be initiated, the method for choosing the person or persons to do the mediating, the schedule of when such choices should be made, and whether these individuals should be internal or external to the contractual relationship.[33] Surveys on these options are provided by Jones (1999) and USAID (1998).

Although comparable measures of the demand and productivity of ADRs across countries and over time are generally lacking, anecdotal evidence seems to make it clear that the use of ADRs has been growing relative to that of the formal court system, world-wide. While a major determinant of this is the growing backlog and delays of the formal system, another may be their relative efficiency and lower cost.[34]

Even under the best of circumstances, such as when there is a broad mandate for reform, the formal judicial system may be difficult to reform as recent experience in Latin America and especially Eastern Europe has suggested. Legislators have to be convinced to change the laws to incorporate needed reforms and, when they do so, have to resist pressures to back away from the reforms. Then the procedures and qualified personnel have to be in place to implement, monitor and enforce laws. If the formal system is the only legal means of resolving disputes, and members of the judiciary maintain the present system in their own self-interest, reform may be even more difficult. If for no other reason than to introduce competition among systems, measures to encourage the use of ADRs such as by increasing their legitimacy and effectiveness may be well justified. Once viable alternatives to the services of the formal system emerge, and those supplying them are faced with loss of business to these alternatives,

[33] Such a distinction might be important if either the voluntary or contract-mandated approach should prove more successful in reaching agreements. Yet, a recent study in the US comparing the ability of voluntary and contract-mandated ADRs to reach settlement found them to be approximately equally successful (reaching agreements in over 75 percent of the cases). The same study showed that the simpler and more informal mediation approach was both cheaper and deemed more satisfactory by the parties involved than arbitration (See "ADR News", *Dispute Resolution Journal* January 1997, p.1).

[34] Some crude evidence of their relative efficiency is provided by cross-country growth regressions. For example, Datta and Nugent (1986) showed that the greater was the importance of the formal, more adversarial dispute resolution system relative to the informal ADRs, the lower was the growth rate of income per capita. This result was quite robust due to the inclusion of other control variables.

even the most corrupt members of the judiciary may see it in their self-interest to accept reform of the formal system.

Another reason for promoting ADRs is their comparative advantage for small firms (SMEs) and the poor. To the extent that ADRs will therefore allow SMEs to protect their legitimate interests vis-à-vis large firms, their encouragement may enhance the competitiveness of the economy, dynamic efficiency and the perceived legitimacy of institutions and the respect for law, all of which could help accelerate development.

Actions that could be taken to encourage the development and use of ADRs in the MENA region are:

(1) To either allow or require certain kinds of cases to be taken out of the judiciary to specialized ADRs;

(2) To recognize the decisions reached by ADRs as legitimate and enforceable by the formal system;[35]

(3) To increase knowledge of the availability of ADRs domestically based on their experience elsewhere;

(4) To encourage professional associations of private individuals and groups to organize and to provide standards for the supply of such services and peer review of their quality;

(5) To overcome the vulnerability of the development of credit bureaus to free-riding by appropriate forms of encouragement;

(6) To encourage the development of small business associations (independent of government) with means of practicing collective enforcement such as by blacklisting parties that default on contracts with association members.[36]

(7) Given the strong preference by foreign companies for extra-territorial arbitration procedures over national courts[37], to sign onto both the U.N Convention on the Recognition and Enforcement of Foreign Arbital Awards and the Model Law on International Commerce Arbitration put forward by the U.N. Commission on

[35] Indonesia has been very successful in both these respects and, moreover, has established a national arbitration board with the country's finest jurists, academicians and retired judges. This board lays down guidelines for arbitration procedures, and in addition arbitrates some of the most complicated cases brought to it. The longest time for completion of any of even their most complicated cases was eleven months and the average closer to half that. The separability principle for arbitration cases wherein the formal judicial system cannot interfere with the substance of arbitration decisions has been firmly established with Supreme Court decisions (Hornick 1991).

[36] In the early 1990s some producers' associations in Tunisia were reported to be doing this with considerable success (Nugent 1989).

[37] For example, a survey by the American business magazine *Business Week* in the early 1990s showed that 97 percent of the executives of multinational corporations interviewed said that they preferred arbitration over litigation as a means of settling commercial disputes (Murphy 1993).

International Trade Law (UNCITRAL). The latter can help to attract an International Arbitration Center to the country (Cremedes 1998), possession of which will naturally make any arbitration awards reached under its auspices seem less "foreign" and more acceptable. Having a center should also help the arbitration culture spread more fully through the society, increasing the supply of skilled practitioners and increasing the accessibility of ADRs.

(8) For countries in which the host country's government or public enterprises may be involved in contracts with foreign investors, to sign onto the 1965 Washington Convention for the Settlement of Investment Disputes between States and Nationals of Other States. This convention allows such cases (with the consent of both parties) to be submitted to arbitration under the auspices of the International Center for Settlement of Investment Disputes in Washington, D.C.

A comparison of Iran and Indonesia provides dramatic illustration of how far some MENA countries have to go in terms of ADR development to be able to attract private foreign investment on any large scale. In Iran for a dispute involving the government or a public enterprise to go to an ADR either domestic or international, an act of parliament (the Majlis) is required (Entezari 1997). By contrast, in a best practice country like Indonesia that has been especially successful in attracting foreign investment, this can be written into contracts and the process is automatic requiring no further approvals (Hornick 1991). It should be mentioned, moreover, that the strong preference of foreign firms for international arbitration as a means of dispute resolution also encourages domestic firms to agree to arbitration by virtue of a substantial price differential in contract terms in favor of ADR.

V. Conclusions

From the above discussion it should be clear that there are several quite different ways to reduce the costs of dispute resolution while simultaneously encourage private sector development. Since to some extent they are alternatives to one another, each with advantages and disadvantages, each country should consider seriously the relative benefits of each alternative relative to its own conditions before choosing its optimal reform strategy. Because of substantial differences among MENA countries in (a) the character and strength of their existing formal and informal judicial systems, (b) the degree of ambiguity in existing law, (c) the extent to which complementary reforms have been or are being undertaken, and (d) the extent to which privatization and private sector development are important social objectives, no single approach is likely to fit all countries of the region.

Recent experience with legal and judicial reform in Latin America and in the transition economies of Central and Eastern Europe, however, has demonstrated that successfully accomplishing either of these reform is quite difficult. Indeed, the greatest success, namely that in El Salvador, has occurred only when both the legal and judicial reforms were done simultaneously with rather massive external pressure, foreign assistance and tremendous pressure from below as well, the latter backed up by the threat of renewal of the civil war. In view of that, judicial reform should be thought of as a complement to legal reform rather than a substitute. Similarly, a healthy ADR system can offer alternatives to formal dispute resolution systems that are likely to be more suitable to some firms, countries and circumstances than to others. When such alternatives are available, the competition they provide may make reform of formal systems easier. All three approaches may therefore be complementary in the broader sense, perhaps explaining why Singapore, a country in which all three approaches are well developed and well-functioning (Chan 1998), scores so well on all institutional indicators in Tables A1-A3.

MENA countries would do well to consider some of the following, more general lessons. First, there is no evidence that legal and other reforms should be undertaken far ahead of other reforms. At the same time, they must not lag too far behind other reforms if the conflict resolution system is not to become a major constraint on efficient exchange and development. Second, even though transplantation of constitutions and entire legal systems from one country to another is unlikely to be either successful or appropriate, with suitable adaptations to local circumstances, best practices elsewhere with respect to individual laws are more effectively and easily transplantable.[38] Third, existing interest groups may impede even socially beneficial reforms to conflict resolution systems if they see these reforms as threatening to their interests. Hence, if such reforms are to succeed, they must get around such potential opposition by incorporating them into the process. Fourth, success in judicial reform may be quite unrelated to the amount of money spent on such reform, making it wise to aim at relatively low-cost, less ambitious reforms, especially in the early stages. Fifth, this experience has again illustrated the point that the types of reforms instituted need to be molded to the circumstances and historical and cultural endowments of the individual country – "One size and model does not fit all". Sixth, in view of the long time interval required for formal legal and judicial reforms and the likelihood of opposition by judges and lawyers to some reforms, it may be useful to emphasize

[38] Cornell and Kalt (1995) show that the degree of success in transplanting a constitution drawn up by the Bureau of Indian Affairs in the U.S. for Indian reservations throughout the country varied with the extent to which pre-existing political systems were consonant with the imposed new constitution. Englebert (forthcoming) makes a similar point in the context of the legitimacy of the state in Africa.

more informal methods of dispute resolution. Seventh, even though the judiciary needs to be independent from the legislative and executive branches of government, it too needs to be monitored by an independent agency, preferably one dominated by professional peers but also including representatives of a broad range of political opinion.

Appendix of
Institutional Indicators

Table A1. Alternative Aggregate Indexes of Economic Freedom

Countries - MENA	Economic Freedom Rating (Maximum = 10)[a]					Index of Economic Freedom (Max = 5)[b]	
	1975	1980	1985	1990	1995	1995	1998
Algeria	2.6	1.5	1.5	2.1	1.9	1.85	1.75
Bahrain	7.2	6.4	7.0	7.1	6.7	3.30	3.40
Djibouti						2.00	1.80
Egypt	2.1	2.7	3.2	4.2	4.0	1.50	1.65
Iran	4.7	2.5	2.7	3.2	2.9	0.30	0.30
Iraq						0.10	0.10
Jordan	4.4	5.3	5.6	4.7	5.4	2.10	2.25
Kuwait						2.60	2.60
Lebanon						2.05	1.75
Libya						0.30	0.30
Morocco	4.2	3.6	4.2	3.5	4.6	2.10	2.05
Oman	5.6	5.8	6.8	6.6	6.3	2.35	2.25
Saudi Arabia						2.10	2.20
Syria	3.7	3.2	2.8	3.4	2.7	0.80	1.00
Tunisia	3.1	3.0	2.7	4.3	4.7	2.15	2.25
Turkey	2.5	2.3	3.7	4.8	4.5	2.00	2.20
U.A.E.						2.90	2.90
Yemen						1.25	0.90
Non-MENA							
Singapore	6.4	6.8	7.7	8.3	8.2	3.75	3.70
Taiwan	4.8	5.3	5.4	6.2	6.8	3.05	3.05
Switzerland	7.0	7.2	7.4	7.3	7.4	3.20	3.10
U.K.	5.1	4.6	6.2	6.7	7.3	3.05	3.05
U.S.A.						3.10	3.10

Sources: [a] Gwartney, James, Robert Lawson and Walter Block 1997. *Economic Freedom in the World 1975-1995*. Vancouver: Fraser Institute. [b] Holmes, Kim R. Bryan T. Johnson and Melanie Kirkpatrick 1998. *1998 Index of Economic Freedom.* Washington, D.C. and New York: Heritage Foundation and the Wall Street Journal.
Note: In the above table the original index (which was an inverse measure of economic freedom) was inverted by subtracting the score given from 5.0 (the highest possible score on the original index).

Table A2. Country Scores on the Components of the Index of Restrictions on Economic Freedom for 1998

Country	Trade Protec -tion	Tax Rate	Govt. Interven -tion	Monetary Policy	Capital Flows	Restrictions on Banks	Wage & Price Controls	Property Rights	Regula -tions	Black Market
Algeria	5.0	3.5	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Bahrain	2.0	1.0	3.0	1.0	2.0	2.0	2.0	1.0	2.0	1.0
Djibouti	4.0	2.0	5.0	1.0	3.0	3.0	3.0	3.0	4.0	4.0
Egypt	5.0	4.5	3.0	3.0	3.0	3.0	3.0	3.0	4.0	3.0
Iran	5.0	5.0	5.0	4.0	5.0	5.0	4.0	5.0	4.0	5.0
Iraq	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	4.0	5.0
Jordan	4.0	2.5	3.0	2.0	2.0	2.0	3.0	2.0	3.0	4.0
Kuwait	2.0	1.0	4.0	2.0	4.0	3.0	3.0	1.0	2.0	2.0
Lebanon	5.0	2.5	2.0	5.0	3.0	2.0	2.0	3.0	3.0	5.0
Libya	5.0	5.0	5.0	2.0	5.0	5.0	5.0	5.0	5.0	5.0
Morocco	5.0	3.5	3.0	1.0	2.0	3.0	3.0	3.0	3.0	3.0
Oman	2.0	3.5	4.0	1.0	3.0	4.0	3.0	2.0	2.0	2.0
S. Arabia	4.0	4.0	4.0	1.0	4.0	3.0	3.0	1.0	2.0	2.0
Syria	5.0	5.0	3.0	5.0	4.0	5.0	4.0	4.0	2.0	5.0
Tunisia	5.0	3.5	3.0	2.0	2.0	2.0	2.0	3.0	2.0	3.0
Turkey	2.0	4.0	2.0	5.0	2.0	2.0	3.0	2.0	3.0	3.0
U.A.E.	2.0	1.0	3.0	1.0	4.0	3.0	3.0	1.0	2.0	1.0
Yemen	5.0	3.0	4.0	5.0	2.0	4.0	3.0	4.0	4.0	5.0
Sing.	1.0	3.0	1.0	1.0	1.0	2.0	1.0	1.0	1.0	1.0
Taiwan	2.0	2.5	2.0	1.0	3.0	3.0	2.0	1.0	2.0	1.0
Switzerland	2.0	3.0	3.0	1.0	2.0	1.0	2.0	1.0	3.0	1.0
U.K.	2.0	4.5	2.0	1.0	2.0	2.0	2.0	1.0	2.0	1.0
U.S.A.	2.0	4.0	2.0	1.0	2.0	2.0	2.0	1.0	2.0	1.0

Source: Holmes, Kim R. Bryan T. Johnson and Melanie Kirkpatrick 1998. *1998 Index of Economic Freedom.* Washington, D.C. and New York: Heritage Foundation and the Wall Street Journal.

Table A3. Country Scores on the Components of the Economic Freedom Rating for 1995

Country	1A	1B	1C	1D	2A	2B	2C	2D	2E	2F	3A	3B	4A	4B	4C	4D
Algeria	6	2	0	0	2	0	2	5	0	0	-	-	-	1	5	2
Bahrain	10	8	10	10	0	2	4	5	0	8	10	10	9	10	5	2
Egypt	8	4	10	10	8	0	2	2.5	0	10	4	3	5	6	5	0
Iran	1	2	0	0	6	2	2	2.5	0	0	8	4	6	1	3	0
Jordan	10	10	0	0	1	6	2	5	2.5	6	8	-	4	8	9	2
Morocco	10	10	0	0	4	2	4	5	0	8	8	3	1	8	5	5
Oman	10	4	10	10	0	4	4	2.5	2.5	10	8	10	9	10	5	2
Syria	3	6	10	0	6	2	0	2.5	0	0	-	-	6	0	6	0
Tunisia	10	10	0	0	4	2	6	5	0	8	5	-	1	8	8	5
Turkey	0	1	10	10	7	4	5	7.5	0	0	5	4	9	7	3	2
Singapore	10	10	10	10	6	8	8	7.5	0	10	9	9	10	10	10	10
Taiwan	10	10	10	10	4	6	6	7.5	5	10	5	5	8	10	5	5
Switzerland	10	9	10	10	5	8	6	10	10	10	2	8	8	10	4	10
United Kingdom	9	9	10	10	2	6	9	10	7.5	10	2	5	10	10	5	10
United States	10	10	10	10	5	8	9	10	7.5	10	3	7	9	10	3	10

Source: Gwartney, James, Robert Lawson and Walter Block 1997. *Economic Freedom in the World 1975-1995*. Vancouver: Fraser Institute.

Note: In each case the scores are assigned in such a way that a high score indicates economic freedom on the dimension measured, the index ranging from 0 to 10, where:

No.	Definition of Component	No.	Definition of Component
1A	Inflation Rate	3A	Transfers and Subsidies as Percent of GDP
1B	Standard Deviation of Inflation Rate	3B	Top Marginal Tax Rate and Threshold
1C	Ability to Own Foreign Currency		
1D	Ability to Maintain a Bank Account Abroad	4A	Taxes on Trade as Percent of Exports Plus Imports
		4B	Black Market Premium
2A	Government Consumption as Percent of Total Consumption	4C	Measure of Trade Openness (Actual Relative to Predicted Trade Share in GDP)
2B	Relative Importance of Government Enterprise	4D	Freedom to Make Investment Transactions w/Foreigners
2C	Extent of Wage and Price Controls		
2D	Entry into Business		
2E	Equality of Citizens Under the Law		
2F	Extent to which Government Regulations Distort Real Interest Rates and Disrupt Credit Markets		

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