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Executive Summary

Introduction

Today, wide-ranging agreement exists that a good business climate is central to economic growth and poverty alleviation, but open questions remain on the role of the state in creating a good business climate.

The *World Development Report 2005* argues that governments should aim at improvements in areas such as stability and security, regulation and taxation or finance and infrastructure. However, they should also enhance the quality of governance by establishing credibility, by fostering public trust and legitimacy, by promoting accountability and transparency and by controlling corruption (World Bank 2004).

Enhancing the quality of governance is particularly important for the economic development in the Middle East and North Africa (MENA), because the countries in this region suffer from severe governance deficits, and sustainable economic growth cannot be achieved in these countries without improving governance, as the *Arab Human Development Report 2004* states (UNDP/AFESD/AGFUND 2004).

Control of corruption is one of the core dimensions of good governance, and, thus, vital for a good business climate (World Bank 2005f). In the MENA countries, one widespread form of corruption is favouritism, locally referred to as "*wasta*". The term is the Arabic word for "relationship" and describes the use of personal connections for private gain.

The aim of this study is to investigate whether and how *wasta* affects the business climate and thereby economic development at large and to point out measures that curtail the use of *wasta* with the aim to improve the business climate.

Our main thesis is that the prevalence of *wasta* constitutes a significant problem for doing business in Jordan because *wasta* affects the quality of the interactions between business people and the state by making them inefficient and unfair. We also state that *wasta* is prevalent and persistent due to political factors, socio-cultural norms and values, a lack of awareness, and negative incentives to refrain from using *wasta*. As a consequence, these factors need to be addressed in order to curtail the use of *wasta*.

The results of the study are based on scientific literature, which we reviewed during the preparation of our research mission to Jordan between November 2005 and January 2006, as well as on our own research in Jordan, which we conducted from February until April 2006.

This report has seven chapters including the introduction. Chapter 2 depicts the conceptual framework of the study. Chapter 3 gives an overview of our research methodology. Chapter 4 describes the most important features of the business climate in Jordan. Chapter 5 analyses the role of *wasta* in Jordan. Chapter 6 outlines the direct and indirect impacts of *wasta* on

state-business relations in Jordan and Chapter 7 concludes with policy recommendations.

II

The Business Climate, State-Business Relations and Favouritism

The quality of the business climate significantly depends on the quality of the relations between the state and private business people. Favouritism makes these relations inefficient and unfair. We identify four sets of factors that lead to the persistence of favouritism and that should be addressed to reduce its negative impacts.

The Business Climate

We define the business climate as the set of factors that shape the decisions of both local and foreign entrepreneurs to do business in a country. A good business climate is characterised by low costs and low risks of doing business, as well as by few unnecessary barriers to competition.

Improving the quality of state-business relations contributes significantly to a better business climate. We define state-business relations as all interactions between private firms and the state and argue that efficiency and fairness are the main criteria for good state-business relations.

Favouritism

Favouritism is the preferential treatment of relatives or acquaintances. It is a form of corruption when it is used by a public or private sector official to unfairly distribute resources and positions to a beneficiary.

However, in contrast to bribery and other forms of corruption, favouritism usually refers to an exchange of non-monetary favours. In addition, while other forms of corruption are usually associated with the notion of illegality and illegitimacy, favouritism is often perceived as an acceptable pattern of social interaction. In many societies, it is seen as a socio-cultural norm. Thus, in many parts of the world, the preferential treatment of friends and family members has become an informal institution which describes adequate and normal behaviour.

The Impacts of Favouritism on State-Business Relations

The prevalence of favouritism has significant direct and indirect negative impacts on state-business relations and thereby on the business climate. Close and trustful relations between private firms and the public sector can be positive when they lower transaction and information costs, but they are negative when they lead to preferential treatment, which makes state-business relations inefficient and unfair.

Favouritism directly affects state-business relations because it implies that a small number of business people have preferential access to government services and to political decision

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making or even both. Overall, this unequal treatment results in unfairness and distorted competition. In addition, it can lead to inefficient state-business relations, because business people have to invest additional time and money to build up personal relations with public officials in order to obtain preferential treatment.

The indirect impacts of favouritism on state-business relations are twofold: First, if employees in the public sector are recruited on the basis of favouritism, many unqualified and unmotivated people may join the public sector. This may cause low-quality public services and lead to deficient state-business relations.

Second, favouritism can negatively affect the quality of laws and regulations that govern state-business relations, and can thus reduce fairness and efficiency in these interactions. Politicians can use their power to favour certain groups such as their tribes or families. In exchange, they expect to receive loyalty and political support from these groups. Therefore, politicians may be more concerned with favouring their clientele than with designing and reforming good economic policies.

Reasons for the Persistence of Favouritism

Four major factors can explain that favouritism persists in many societies as an informal institution:

A first factor is that people are often not aware of the negative impacts favouritism has for the whole society. In addition, they may also be unaware of alternative, fairer ways of interaction to achieve a specific goal.

A second factor is the individual incentive structure of favouritism. The prevalence of favouritism as an informal institution can be modelled as a collective prisoners' dilemma: All members of society would be better off if everybody complied with fair formal rules, compared to a situation in which all individuals revert to the use of personal connections. However, for the individual, it is always profitable to use her or his personal connections, regardless if other members of society use their connections or not.

A third factor is that favouritism can be related to and supported by prevailing socio-cultural norms and values. As has already been noted, it is associated in many societies with sociocultural values, such as solidarity and loyalty with relatives and friends. Refusing to do a favour is often perceived as an offence against prevailing social norms.

A fourth factor can be that a small powerful group, usually the elite of a country, benefits disproportionately from favouritism and therefore opposes any step against it, although this would benefit the rest of society and economic development at large.

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Approaches to Reduce Favouritism in State-Business Relations

Given that these four factors can be responsible for the prevalence of favouritism, measures against it might have to take four different points of departure:

Raising awareness: Awareness about the negative consequences of favouritism and alternative ways of interaction can be raised by running public awareness campaigns, by enhancing the freedom of the media, and by encouraging civil society participation.

Addressing individual incentives: In addition, the incentive structure for business people, politicians and civil servants may have to be altered. This can be achieved by strengthening transparency and accountability in the public sector, by raising sanctions against favouritism and by rewarding public sector officials that refrain from favouritism. In addition, on a decentralised level, people can form groups in which they agree on compliance with formal rules.

Addressing socio-cultural norms and values: Another possible point of departure for measures against favouritism is to address the impact of socio-cultural factors. Favouritism should be detached from prevailing socio-cultural norms and values, e.g. through awareness campaigns. Furthermore, expanding loyalty and solidarity from the family to the whole society and nation might also help to curtail favouritism.

Overcoming opposition to change in the authoritarian regime: Naturally, the beneficiaries of favouritism do not want the phenomenon to be eradicated. Nevertheless, those who are negatively affected by a system based on favouritism can overcome this opposition, by e.g. forming a coalition of change against the use of favouritism and by establishing pressure groups to lobby against favouritism.

Research Methodology

Based on the preceding conceptual considerations, we formulated our main hypothesis for the specific case of Jordan. To search for empirical evidence for our main hypothesis, we conducted an eleven-week field research in Jordan.

Hypotheses

Our main hypothesis refers to the negative influence of *wasta* on the business climate in Jordan:

The prevalence of wasta constitutes a significant problem for doing business in Jordan.

From our main hypothesis we derived four subordinate theses to guide our empirical research:

Hypothesis 1: The business climate in Jordan suffers from deficits in state-business relations.

Hypothesis 2: The problem of wasta in Jordan is prevalent and persistent.

Hypothesis 3: Wasta makes state-business relations in Jordan inefficient and unfair.

Hypothesis 4: Yet, something can be done to fight the use of wasta in Jordan.

In accordance with the principles of grounded theory, we followed an iterative research approach: a continuous analysis of our interviews helped us to re-formulate and adapt our main hypothesis and the subordinate theses as required.

Method of Data Collection

We conducted our empirical research during our eleven weeks research mission to Jordan from February to April 2006. Our research can be divided into four phases:

In the first phase, we conducted 99 semi-structured "expert interviews", i.e. interviews with resource persons from the government of Jordan, non-governmental organisations (NGOs), academia, the media and foreign donors. These interviews were intended to provide us with basic information on the subject of our study.

The second phase consisted of semi-structured interviews with 58 local and foreign business people in different sectors, to analyse the problems of investors and companies in Jordan. In the third phase of our field research, we conducted semi-structured interviews with 18 medium- to high-ranking civil servants in different state authorities to get an insight into how public sector employees perceive their interactions with business people.

In the fourth phase, we distributed an anonymous standardised survey among 180 low- to medium-ranking civil servants to learn about their opinion and to validate the answers of medium- to high-ranking civil servants.

The Business Climate in Jordan

Jordan's business climate is slightly above average in regional as well as international comparison, but some significant deficiencies remain – especially in the field of state-business relations.

During the last years, the country's macro-economic performance has been quite satisfactory, which was however due to windfall profits rather than a rise in productivity and competitiveness. The country has benefited especially from a rise in budget transfers from the Gulf countries and from the West as well as from increases in private transfers from Jordanian migrant workers in the Gulf and from wealthy Iraqis, who invested into real estate in Jordan.

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It is, however, uncertain whether these external effects are going to last. Furthermore, the current economic growth rates are still not sufficient to cure Jordan's main economic disease – the high unemployment. Therefore, Jordan must become more independent from windfall profits and rents by developing its own private sector. A better business climate is crucial for this goal, because it does not only raise the level of entrepreneurial activity of Jordanians, but also helps to attract foreign investors.

Today, the quality of Jordan's business climate still leaves much room for improvement. Despite significant progress during recent years, it ranks only slightly above average, both in comparison to other Arab states and from a global perspective. Several significant weaknesses remain. However, a mediocre position is not enough for a country like Jordan: To compensate for the disadvantage of having a small market size, the country has to offer extra-ordinary investment conditions, i.e. it must have an excellent business climate to be able to compete.

From our empirical research in Jordan we draw the conclusion that the quality of state-business relations is among the main weaknesses of the Jordanian business climate. 80 % of the business people that we interviewed admitted to have problems in at least one field of state-business relations. The most frequently mentioned field of problems was the process of registering and licensing a company.

The results of our interviews with business people in Jordan indicate that state-business relations are characterised by a lack of efficiency and fairness. More than two thirds of the respondents complained about the long duration of administrative procedures. Likewise, one third confirmed cases of preferential treatment on the basis of *wasta* in the public sector.

The explanations that interviewed business people mentioned for these difficulties in interactions with the state can be grouped into two clusters: first, problems concerning the quality or quantity of regulations, such as inappropriate regulations or over-regulation and dispersed decision-making. Second, deficiencies in the institutions that are charged with implementing regulations, such as a lack of motivation and qualification of public sector employees. When contrasted with the opinions of civil servants, it remains, however, unclear whether the observations of the business people actually reflect the reality in the public sector.

Wasta in Jordan

In Jordan, favouritism is called *wasta* – although the literal translation of the Arabic word is just 'connection'. *Wasta* plays an important role in many fields, among them state-business relations. People's perception about *wasta* is ambiguous. Most Jordanians keep on using their *wasta* although they would prefer to see the widespread use of *wasta* in their country to be eliminated. Yet, this is a difficult task, because several factors contribute to the persistence of *wasta* in Jordan.

The Role of Wasta and People's Perception About It

The results of our research show that the use of *wasta* is still very common in Jordan in many different areas. Apparently no social group in the Jordanian society is principally exempt from using *wasta*.

The perception of *wasta* in the Jordanian society is ambiguous. People disapprove the use of *wasta* mainly because it is regarded as unfair. However, some interviewees claimed that without using *wasta*, especially the poor would not be able to get their rights. Others said that *wasta* had a stabilising effect on the Jordanian society or that it is inseparably linked to cherished institutions like the family, the tribe or the Jordanian culture in general and to prevailing socio-cultural values like solidarity.

Jordanians also have different opinions on the relation between *wasta* and bribery. While the use of *wasta* is sometimes legitimised and justified by the argument that it can serve a good purpose or that it is part of the Jordanian culture, bribery is clearly considered as an unacceptable and illegal act in Jordan.

Nevertheless, the majority of the Jordanians want *wasta* to be eliminated.

Reasons for the Persistence of Wasta

The prevalence of *wasta* in the Jordanian society has decreased. However, it remains a very widespread phenomenon. We argue that the persistence of *wasta* can be attributed to four main sets of factors:

Lack of awareness: Many Jordanians seem to be aware of the negative consequences of the widespread use of *wasta*, but they are not aware of fairer alternative patterns of interaction that can also help them obtain what they need. In addition, they lack the necessary incentives to actually use these alternatives.

Individual rationality: *Wasta* is persistent because individuals find it difficult not to use it, even if they are convinced that it poses a major problem to the Jordanian society. They continue to use *wasta* because in a society in which everybody else tries to get preferential treatment because of his *wasta*, they would be worse off without using it. Moreover, people are afraid of being sanctioned by their social environment when they do not behave in the way they are expected, i.e. when they refuse to serve as a *wasta* and provide preferential treatment to their relatives and friends.

Socio-cultural values and norms: Another factor is that the use of *wasta* is linked to certain cherished values and, that it is considered as a social norm. Jordanians themselves explain and justify their use of *wasta* in cultural terms and often refer to Jordan's tradition of tribalism, which, in their opinion, is based on the same social norms as *wasta*, namely solidarity, reciprocity

and loyalty.

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Opposition to change within the authoritarian system: A fourth factor is the neo-patrimonial character of Jordan's authoritarian political system, which contributes to the persistence of the use of *wasta* in two ways:

First, the power of the regime is partly based on personal relations with influential social groups. The rulers provide preferential treatment in exchange for political loyalty and support. Therefore, they do not have much interest in fighting the use of *wasta*: This might undermine their influence and power and thereby destabilise the political system. In addition, limiting the role of *wasta* would decrease the influence of tribal leaders and strengthen the role of Jordanians of Palestinian origin in the Jordanian state. Both factors are believed to bring about political disturbance and instability. Yet, although *wasta* plays such a prominent role in the political system, some political actors assume the risk and push for reforms that reduce the influence of *wasta*.

Second, the authoritarian regime lacks internal checks and balances and makes it very difficult for external actors, such as the media, NGOs or political parties to organise and push for the absence of *wasta* in political procedures.

The Impact of *Wasta* on State-Business Relations in Jordan

Wasta has direct and indirect negative impacts on state-business relations in Jordan. It has direct impacts on the access to government services and political decision-making, which may imply that some entrepreneurs use resources unproductively.

Unequal access to government services: *Wasta* directly influences decisions taken by the administration, the government and the judiciary. Our data show that it is possible to speed up administrative procedures for people who know someone in the public administration and that Jordanian business people make ample use of this possibility. Moreover, business people who have *wasta* can even get easier access to government services, valuable information, licenses and permits for profitable business activities, tenders, tax exemptions, and the courts to get their rights enforced. As a consequence, the prevalence of *wasta* implies not only that some business people get their procedures done more quickly than others, but also that some business people who have *wasta* enjoy exclusive benefits that other business people do not enjoy at all.

Unequal access to political decision-making: In addition, our data show that the influence of the established Jordanian business elite is partly based on *wasta*. One crucial condition for this is the fact that business associations fail to represent the interests of their members. As a result, state-business relations at the political level are highly unfair, which implies that many laws and regulations are designed to the benefit of influential business people, thereby severely distorting competition.

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Unproductive use of resources to obtain wasta: Our company survey indicates that some Jordanian business people devote resources they could otherwise use for productive purposes to improve their *wasta* in order to obtain preferential treatment. Investing in *wasta* can basically be done in three different ways: employing an agent, establishing relations by getting to know influential people, and giving small gifts or a discount on his products to public sector employees.

In addition to direct impacts, *wasta* has indirect impacts on the quality of public sector services and the legislative framework for doing business.

Lower quality of the public sector service: *Wasta* can negatively influence the quality of services delivered by the public sector and, thus, worsen state-business relations.

Our data show that *wasta* plays a major role in the recruitment of public sector employees. If civil servants are recruited through *wasta* instead of competences and merit, it is likely that more unskilled and unmotivated people work in state authorities. In addition, *wasta*-based recruitment can lead to overstaffing in the public sector. As a result, to keep superfluous civil servants busy, it is likely that additional steps are created in administrative procedures, such as licensing. This will in turn increase the duration of these procedures and make them more complicated.

Certainly, *wasta*-based recruitment is not the only factor that explains the lack of qualification of public sector employees and the long duration of procedures. Also, several interviewees noticed major improvements in recruitment and promotion procedures.

Lower quality of the legislative framework: Weaknesses in the legal framework for doing business in Jordan can also be attributed to a certain degree to the influence of *wasta*: First, most members of parliament (MPs) are not elected because of their qualities in legislation and policy formulation but because they are a good *wasta* for their constituencies. As a consequence, they have no incentive to make good laws and thereby demonstrate their qualification as a politician. Second, many ministers are appointed by the King because of their *wasta* and not because of their competence. As a consequence, ministers are often not able to perform well and many of their decrees are of poor quality.

Measures Against the Use of *Wasta*

Several measures that have helped to reduce the use of *wasta* in Jordan and to limit its impact on state-business relations have been taken in the last years. While of them have yielded good results, *wasta* still remains prevalent. Therefore, the on-going reforms should be continued and additional measures should be taken.

Past Measures

The government of Jordan has already made some achievements in reducing the incentives for public sector employees and business people to use *wasta*. In addition, the government and some NGOs have undertaken efforts to raise people's awareness about the negative consequences of *wasta*. However, only very little has been done so far to address the political and socio-cultural reasons for the persistence of *wasta*.

In a speech in summer 2005, the King has set the fight against the use of *wasta* on the political agenda. Some NGOs have run public awareness campaigns to inform the Jordanian population about the negative consequences of using *wasta* as well as about the advantages of complying with the formal rules. Other NGOs have conducted research and disseminated studies on the topic. However, even though these efforts were steps in the right direction, they have not yet resulted in widespread awareness about the negative impact of *wasta*.

In order to change the incentives that prompt people to use *wasta*, several new sets of laws and regulations have been drafted, and plans exist to make government entities that fight corruption more effective. Moreover, some administrative procedures have been streamlined and standardised and human resource policies are being reformed. As a result, existing plans need to be fully implemented and additional measures need to be taken to realise an incentive structure that prevents public sector employees and their customers alike from referring to *wasta*.

So far, progress in broader political reforms that strengthen internal checks and balances and increase accountability has been slow. It remains difficult to form groups along common interests, because the freedom of association and the freedom of speech are restricted by the executive. As a result, efficient pressure groups with the aim to fight the use of *wasta*, i.e. a coalition for change that demands accountability and transparency, have not yet emerged. Nevertheless, there are a few groupings, namely a small number of innovative and more marketoriented business associations and some NGOs, that could serve as a starting point for building a coalition for change.

Recommendations

The Jordanian state and the private sector are the main stakeholders in state-business relations. They therefore have a key responsibility in taking measures against the use of *wasta*. NGOs, the media, and foreign donors should support their efforts.

The Jordanian state: The state is by its power monopoly predetermined to head the fight against the use of *wasta*. Jordanian political leaders should make this task a priority issue on their agenda. First, they ought to take measures to raise people's awareness about the negative consequences of *wasta* and about the availability of alternative solutions. Second, they should alter the incentive structure to use *wasta*, e.g. by strengthening rules that prohibit the use of *wasta*, setting up effective anti-corruption institutions, increasing accountability and continuing to streamline and standardise procedures. Third, the state can contribute to changing the mindset of the people and thereby detach the use of *wasta* from socio-cultural values. However, all these measures have to be embedded in larger political reforms, as has already been foreseen by the National Agenda, since measures at the administrative level will only be successful in the long run if they are accompanied by political liberalisation along with increased accountability and democratic control over the political process.

The private sector: As a main stakeholder in state-business relations the private sector also has a key responsibility in fighting the use of *wasta* in this particular field. Business people, as well as business associations and professional unions should contribute to raising awareness, lobbying for institutional change, and refraining from the use of *wasta*.

NGOs and the media: Even though NGOs and the media are no direct stakeholders in state-business relations, they can play an important role in reducing the impact of *wasta* in this field. They should act in the public interest and assume three tasks: (i) promote reform and raise awareness, (ii) mediate in conflicts between different groups of stakeholders, and (iii) speak out for those who find it difficult to voice their concerns. However, in practice, their scope of action is limited, since the work of NGOs in Jordan is restricted and press freedom is not fully guaranteed.

Donors: The possible scope of action for donors in fighting *wasta* in Jordan is also limited. Jordan should be able to finance and organise most of the measures against the use of *wasta*. In addition, it is difficult to say whether the government of Jordan is in fact committed to reducing the use of *wasta*. As a consequence, donors should carefully reflect whether they ought to really support Jordan in this field.

Donors who decide to support Jordan in reducing the use of *wasta* should concentrate on three tasks: First, they should encourage the government of Jordan to increase and intensify efforts against the use of *wasta* and to undertake more fundamental political reforms. Second, they should provide technical assistance to Jordanian NGOs that fight against *wasta* and other forms of corruption. Third, donors should by all means set a good example of transparency and control of corruption in their own work.