Corporate Governance & Business Ethics in Lebanon
Dr. Nasser Saidi*
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Launch of RDCL "Code of Business Ethics"
Beirut, 28 April 2004

Excellencies, Ladies and Gentlemen:
Let me begin by applauding the important and innovative initiative by the Rassemblement de Dirigeants et Chefs d'Entreprises Libanais (the RDCL), of advocating a "*Code of Business Ethics*". The launching of the Code demonstrates that our private sector institutions, our business organizations and NGOs are active, dynamic, resourceful and forward-looking. It also demonstrates that the will to change and reform is present and stems from within; it is not imported or imposed. I hope that our other business organizations will follow the lead of the RDCL.

The RDCL "Code of Business Ethics" Initiative
The RDCL "*Code of Business Ethics*" is a *voluntary* instrument and tool to promote business ethics, professional integrity, transparency in conduct and transactions, and the respect of contracts and commitments. It aims to combat bribery by enjoining the members of the RDCL and the signatories of the "*Code of Business Ethics*": "to reject bribery in all of its forms". Importantly, it also calls for the dissemination and non-withholding of information –a critical factor in ensuring the efficient operation of markets- and aims to enhance competition. Indeed, it is the concealing of information along with inadequate monitoring and supervision, fraud and the dissemination of incorrect and deceitful information on financial status and corporate actions, that underlie the demise of Enron, WorldCom, Tyco, Vivendi, Marconi, Ahold and Arthur Andersen and more recently Shell. Closer to home, we have lived similar episodes with the spectacular sagas of the Bank Al-Madina and related institutions. They have all been severely punished by the market. It remains to be seen whether the judiciary will be as severe.
I hope that many RDCL and non-RDCL members, individuals and businesses, will sign and promote the "Code of Business Ethics". This will be a visible, pro-active nucleus in favour of business integrity and ethics, and against corruption and bribery. The larger the coalition and network, the more effective is the action.

To move forward and create a mutually reinforcing mechanism, the RDCL and other business associations can create a Self Regulatory Organization, (SRO) that will follow-up on compliance with the "Code of Business Ethics" and corporate governance (CG) principles. Such SROs have been useful in a number of contexts, including in ensuring compliance with standards and codes in a number of professions, including the medical, legal and financial services. Let me mention a successful example from Lebanon: the anti-money laundering "Convention de Diligence" that was signed between the banks and the Association of Banks in Lebanon (ABL), and preceded passage of the anti-money

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* Former Minister of Economy & Trade, Minister of Industry and First Vice Governor of BDL.

laundering legislation and measures implemented under Law No. 308. The Convention was an example of an SRO and established a Committee for implementation of the Convention. This was successful in that the methodology and procedure prepared the banks for the implementation of Law 318 and compliance with anti-money laundering measures and decrees. This may be a good example in seeking endorsement and implementation of the OECD CG Principles and other anti-corruption tools.

Bribery & Corruption

Empirical evidence suggests that well performing institutions, enabling legal infrastructure, incentive-compatible regulatory regimes and enforcement, what is now called "good governance", are major contributors to economic growth & prosperity and democracy.

A recent report by the World Bank has advanced some startling numbers on the extent of bribery and corruption in the world. It estimates that on annual basis some US$1,000 billion (a trillion dollars!) is exchanged in bribes, or a staggering $2.7 billion per day is paid in bribes in both developing and rich countries! This compares with an estimated total size of the global economy of about $30 trillion. The evidence also suggests that the economic crimes associated with bribery and corruption, are not limited to poor countries, a particular political ideology, rightist or leftist regime, specific cultures, religions or geographical regions. The cancer of corruption and bribery is a world-wide phenomenon.[1]

A recent study provides an eloquent summary:" Systematic research conducted recently by a number of authors finds that the more corrupt a country, the slower it grows. There are several channels through which corruption hinders economic development. They include reduced domestic investment, reduced foreign direct investment, overblown government expenditure, distorted composition of government expenditure away from education, health, and the maintenance of infrastructure, towards less efficient public projects that have more scope for manipulation and bribe-taking opportunities."[2]

In this context, a recent report on Global Corruption from Transparency International[3], Lebanon ranks 78th out of 133 countries surveyed; an unenviable ranking! Similarly, the recent World Bank report on Governance in the MENA countries reveals that Lebanon falls below the average for the MENA countries as well as the Upper Middle Income Countries on indices of public accountability, quality of administration and the overall quality of governance! Importantly, the WB report concludes that "simulations find that if MENA had matched the average quality of administration in the public sector for a group of good-performing Southeast Asian countries (Indonesia, Malaysia, the Philippines, Singapore and Thailand), its growth rates would have been higher by about one percentage point a year."[4] I have no doubt that we could have doubled our growth rate, reaching an average 5% to 6% per year with better public governance!

[1] See Kaufmann, D. (2004).
[2] Wei, S-J, (2002).
[3] See the Global Corruption Report 2004.
[4] World Bank (2003), p.9.

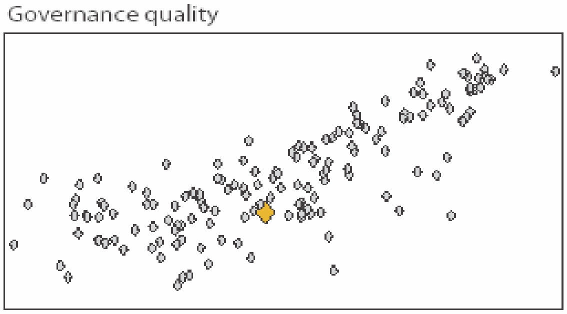
Measures of public sector performance (2000 or most recent)

	Lebanon	MENA13	UMIC
Number of procedures to start business	8	..	11
Judicial efficiency (contract enforcement)			
Number of procedures	27	23	27
Number of days	721	284	351
Government expenditure (% GDP, 1999)	35.7	31	..
Public spending on education (% GDP, 1998)	2.1	6.7	4.2
Public spending on health (% GDP, 1998)	2.5	2.9	3.5
Infant mortality (per 1,000 live births)	28	31	24
Maternal mortality (per 100,000 live births, 1995)	130	180	112
Illiteracy (% population age 15+)	14	28	9
Female illiteracy (% female population age 15+)	20	38	10
Ratio of girls to boys in primary and secondary education	102	93	101
Access to improved water (% population)	100	83	88
Access to improved sanitation (% population)	99	85	79
Roads, paved (% total roads, 1999)	85	65	51
Telephone mainlines (per 1,000 people)	195	123	192

Measures of governance quality

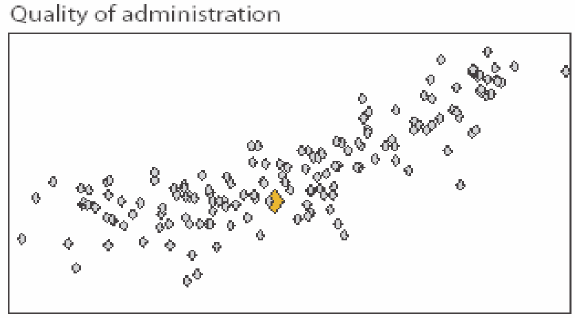
(0–100, higher is better)	Lebanon	MENA15	UMIC
Index of public accountability (IPA)	42	32	65
Index of quality of administration (IQA)	35	47	56
Index of governance quality (IGQ)	32	37	56

Governance quality



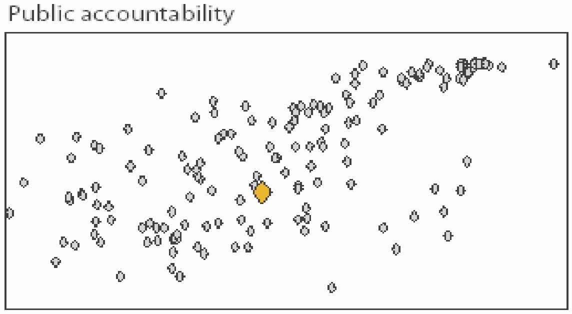
Per capita income

Quality of administration



Per capita income

Public accountability



Per capita income

What is Corporate Governance and Why is it Important?
There are two definitions: one narrow, the other wider and more comprehensive. The narrow definition focuses on CG as a source of shareholder value: good CG leads to better company performance, higher profitability and efficiency. A wider definition takes into account all the company's stakeholders and corporate social responsibility. Thus CG comprises the legal infrastructure organising business (corporate law, securities law, accounting rules), business ethics and the overall business environment.
We care about CG because it is part of the institutional infrastructure (laws, regulations, institutions and enforcement mechanisms) underlying sound economic performance. Evidence and experience demonstrate that cross-country differences in laws & enforcement affect ownership structure, dividend payouts, availability & cost of external finance and market valuations.[5]
Better CG is highly correlated with better operating performance and market valuation of companies. By preserving and protecting property rights –in particular those of minority and foreign shareholders- it encourages innovation and long-term investment in human and physical capital, foreign direct investment, as well as the creation of intellectual property. By stimulating performance, generating higher returns and profitability of companies, it encourages higher total factor productivity growth; the major source of economic growth. By limiting the abuse of power by corporate insiders, it creates an efficient mechanism for transferring wealth between generations. By monitoring managers of companies in both the financial and 'real' sectors and making them accountable for their actions, it protects investors' interests; in turn, this encourages both domestic and foreign direct as well as portfolio investment.

Developing a Programme for Governance
How do we move forward? We need to invest in building institutions –laws, organizations, rules-of-the game, and a framework for economic activity- that will allow us to have political and economic governance at a par with international codes and standards, allowing us to compete in regional and world markets.

By complying with the Core Principles for Effective Banking Supervision –as issued by the BIS- and related prudential and regulatory measures, modernizing our payment system in compliance with international standards[6], applying international accounting standards, by instituting an effective and independent Banking Control Commission, and acting to ensure market integrity through anti-money laundering legislation and instituting a Special Investigation Committee, we have achieved effective corporate governance in our banking sector in Lebanon. The result has been a performing sector, able to attract deposits and investments from the domestic and international markets, able to list shares and issues securities internationally. This experience provides an example for other business sectors.

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[5] See Litan et al, (2002).
[6] The Core Principles for Systemically Important Payments, as issued by the Committee for Payment and Settlement Systems, of the Bank for International Settlements.

Such an agenda requires a two part programme of action: public governance and corporate governance. My focus today is on CG. However, I will briefly mention the role of government in enabling and improving CG.

Public Governance

Improved public governance implies improved public accountability and the quality of administration, and addressing the problem of corruption. Combating corruption requires an *anticorruption strategy*. It is not a matter of isolated actions or decisions. Nor is it a matter of passing an anti-corruption law and creating, as some countries have done, anticorruption committees. Lebanon's experience and evidence from other countries have shown that an anticorruption strategy requires leadership that is willing to pay a political price to combat corruption. It requires strong enforcement by the judiciary, and requires widespread conviction among politicians, the executive & administration that bribery and corruption are costly to the country, to their interests and to economic and social development. So what do we need to do?

At the level of government, awareness should be raised that addressing the issue of corruption, bribery and waste are a priority, and that –similar to anti-money laundering- Lebanon should comply with international standards and conventions. Although we have signed the '*UN Convention against Trans-national Organized Crime'* in December 2001, it has not yet been ratified. More important, we have not signed the important '*UN Convention against Corruption'* which was approved and signed by 106 countries in Merida, Mexico in December 2003.

A major area for improvement is public procurement, of the supply of goods and services to government. There are two parts to the answer. First, we need to reduce the size of government, the total amount of resources available to be spent through government. This reduces the scope for bribery and corruption. Let the private sector produce more of the goods and services, including public utilities. The second part of the answer lies again in the forces of competition: establish government procurement policies that are transparent and open to many bidders, to the forces of supply and demand.

This is why I advocate passing a modern *Government Procurement Law*, including e-Procurement.

For the same reasons, we should also support the rapid, comprehensive introduction of ***e-government*** in Lebanon, as an important tool for administrative reform, reduced cost of delivery of government goods and services and of government procurement, and to help in removing much of the corruption and bribery that are rampant in the private and public sectors.

Corporate Governance

We must deal with the 'dualistic' nature of the Lebanese and MENA economies. State-owned Enterprises (SOEs) dominate many economies, while the majority of private business & corporations in MENA are 'Small and Medium Enterprises' (SMEs) & are family-owned. In Lebanon public utilities (power, water, transport, and telecommunications) are State owned, while more than 85% of industrial companies have less than 10 employees and 90% of SMEs are individual or family-owned.

Our SMEs face a set of "existential" issues. Succession: who will carry-on the business? How to ensure survival and continuity? How to separate ownership from management, and are there trade-offs? Separation allows specialization in mobilizing capital from shareholders and /creditors, and efficient resource use through professional management. A further potential benefit from the separation of control and ownership is increased efficiency and profitability from the professionalism of corporate management. Our banking and financial sector, that was largely family-owned a decade ago, is effecting this transition, with success.

This is a challenge many developing, transition and emerging-market countries face, whether in the context of privatisation of state-owned enterprises or in the succession of family-owned corporations from one generation to the next. The challenge is both to expand the pool of qualified managers, and to develop a reasonably competitive market for management competencies.[7]

We should advocate and work for the application of CG principles to all our SOEs. Consider the improvements in management, accountability, efficiency and productivity that would result!

On a practical level, however, we should be aware that our small and medium enterprises (SME's) will have difficulty enforcing the principles & standards of corporate governance. Thus, the question of how to reduce the cost of compliance and transparency must be addressed. Business organizations such as the RDCL have an important role to play in facilitating the implementation and compliance of CG principles, through the "*Code of Business Ethics*", raising awareness, providing technical assistance and other tools.

In Lebanon there is a common perception and misconception that corporate governance is of little importance, since we have a small number of companies listed on the Beirut Stock Market and without widely traded shares. The evidence, however, is that improved CG -including at the level of SMEs- leads to easier *access* to credit as well as the availability of finance at better terms and lower cost. As a result, firms are able to finance the investment in real assets, physical, human and new technology, at improved terms and conditions.

However, we need to be clear about the issues, our vision and objectives. The important issue is the development and application of the principles and institutions of corporate governance. It is the challenge of moving from institutions of economic and political governance that tend to be heavily relationship-based to institutions that are more effectively rules-based.

[7] See the discussion in Oman et al. (2003).

Advocating Good Governance in Lebanon

How do we advocate better corporate governance? One way is to seek implementation of 12 key, internationally recognized, generic standards for sound financial systems[8] developed by the Financial Stability Institute, and to follow up on Lebanon's (and other Arab countries) compliance with these standards. The standards are organized under three broad areas: Macroeconomic Policy and Data Transparency; Institutional and Market Infrastructure, and Financial Regulation and Supervision.

12 Key Standards for Sound Financial Systems

Codes and Standards	Comments
Monetary and Financial Policy Transparency—this standard is formulated in the form of a Code of Good Practices on Transparency in Monetary and Financial Policies, with the issuing body being the IMF.	Lebanon is seeking to implement the Code.
Fiscal Policy Transparency—the standard is the Code of Good Practices in Fiscal Transparency; the issuing body is the IMF.	Lebanon is seeking to implement the Code.
Data dissemination—the standards are the Special Data Dissemination Standard (SDDS)/General Data Dissemination System (GDDS), (both issued by the IMF).	Lebanon has now entered the GDDS and the Central Bank, with assistance from international institutions (IMF, World Bank) is establishing the Lebanese Statistics Portal (LebStat), which will provide a statistics gateway, a single-access point to available economic, social, financial and real sector data.
Insolvency and Bankruptcy Procedures (World Bank)	The Lebanese government is considering drafting a modern insolvency and bankruptcy law. Principles of bankruptcy are essential for the viability of corporate governance.
Principles of Corporate Governance. (World Bank and OECD)	The standard defined by the OECD awaits formal adoption in Lebanon by relevant institutions such as Chambers of Commerce, business & professional associations.
Accounting—the standard is the International Accounting Standards, issued by the IASB	Lebanon recognizes the IAS, but there is no mandatory implementation by business or effective enforcement.
Auditing—the standard is enforcing the International Standards on Auditing, issued by the IFAC	Lebanon recognizes the ISA, but there is no compliance mechanism for the auditing and related professions.
Payment and Settlement—the standards are the Core Principles for Systemically Important	Lebanon has, with the assistance of the IMF, modernized its payments media and systems,

[8] See the FSF - Financial Stability Forum: 12 Key Standards for Sound Financial Systems

Payment Systems and the Recommendations for Securities Settlement Systems, issued respectively by the BIS-CPSS and the BIS-IOSCO (BIS-IMF-World Bank)	bringing them into compliance with BIS Core Principles and related recommendations. If payment systems are not safe, sound, and efficient, firms would not be able to conduct business properly.
Market Integrity—the standard is establishing the "40 Recommendations" and the "Eight Special Recommendations against Terrorist Financing", issued by the Financial Action Task Force (FATF).	Lebanon has issued and enforces a modern Anti-Money Laundering Law (No. 318, April, 2001) and set-up a Special Investigation Committee.
Banking Supervision Bank for International Settlements	Lebanon is at the forefront among emerging economies in the application of the Core Principles for Effective Banking Supervision issued by the BIS and related measures, such as the creation credit and audit committees, general audit, and independent surveillance reporting that are directly accountable to the board of directors. It has a well-managed, professional and independent Banking Control Commission.
Securities regulation—the standard is the implementation of the Objectives and Principles of Securities Regulation, issued by the IOSCO.	Lebanon cannot effectively enforce principles and regulations in this key area, until the government establishes an independent capital market authority with the relevant mandate. A modern Capital Markets Law has been waiting agreement by Government for the past five years! Recent experience highlights the importance of having a centralised, politically independent, accountable, well-funded and motivated securities commission which is endowed with adequate regulatory powers.
Insurance supervision—the standard being the Insurance Core Principles (ICP), issued by the IAIS	An independent Insurance Control Commission has been established as a result of passage of a Law (in 1999) leading to extensive reform of the insurance industry in Lebanon.

The main message here is that groups advocating corporate governance reform in Lebanon should lobby and seek the adoption and implementation of the above-mentioned key standards for sound financial systems. They should formulate an action plan and mobilize themselves, with the assistance of the media and local civil society organizations. Seeking implementation of the core standards for sound financial systems should be part of the action plan. A combination of economic incentives, mandatory disclosure of financial and corporate information, self-regulation and enforcement of laws and regulations may be needed for corporate governance to flourish.

But it all starts with the private sector being pro-actively *engaged* in the development of the corporate governance environment. A private sector task force promoting corporate governance or business associations developing codes of corporate governance for its members are promising starting points.

Recommendations and an Agenda for Action:

As a country emerging from conflict, Lebanon faces the challenges that virtually all developing, transition and emerging-market economies now face: how to create institutions and respect their rules. We need to move from discretionary-management and relationship based policy making and governance to institution and rules-based policy-making and governance. Economic security is based on the pillars of good public and corporate governance.

1. Appoint a Commission to develop set of Core Principles for the Corporate Governance of large and exchange listed companies. These should be based on the OECD CG Principles, which focus on five core issues: shareholders' rights; the equitable treatment of shareholders, especially minority shareholders; the role of stakeholders, notably including employees; information disclosure and transparency; and the responsibilities of corporate directors and boards. For family-owned companies, SMEs and SOEs, CG principles should be developed based on the Cadbury Report principles.

2. The CG principles should include a number of changes, including possible amendments to Commercial Code:
   1. Strengthen Minority & Foreign shareholder protection
   2. Identify the responsibilities of the Board of Directors and individual directors
   3. Accounting and auditing
   4. Transparency of Ownership and Control
   5. Regulatory Environment

3. Laws & Institutions**;** amend laws to:
- Introduce a modern *Securities Law*
- Modernize & Reform *Insolvency & Bankruptcy Law*
- Introduce a comprehensive *Capital Markets Law*
- Right to Know & Right to Tell: prepare and enact a '*Freedom of Information Act'* and a *"Data Privacy Act"*

4. Develop a **Central Credit Organization** to report on sources and uses of credit (market-base, bank, non-bank & supplier credit). More and improved credit information leads to lower borrowing costs, improves access to credit, develops a credit rating system, improves the 'good standing' of companies, encourages investment and facilitates access to export markets.

5. Set-up a national '**Companies House'** that will complement and expand the Commercial Register by centralizing financial reporting and disclosure of corporate actions.

6. Encourage set-up of *local rating agencies* to ease compliance with Basel II banking standards.

7. Develop incentives for information disclosure and CG:

- Set-up national websites of good CG companies
- OECD-WB to set-up a gateway that would provide a Network for good CG complying companies

The Lebanese Transparency Association (LTA) has established a **Task Force on Corporate Governance for Lebanon**. The aim will be to raise awareness of CG issues, work with all stakeholders in the private and public sectors for the adoption and effective implementation of CG principles in our companies and businesses and professionals. I invite you to participate in our activities. It is in our national interest. More generally, the Task Force will focus on the important building blocks that insure Institutional and Market Infrastructure, namely: Insolvency, the OECD Principles of Corporate Governance, and the supporting pillars of the implementation of International Accounting Standards (IAS), and International Standards on Auditing (ISA). Our national Task Force for Corporate Governance will endeavour to be active at creating a Regional Round Table for the MENA region to support legal and institutional change, produce policy-oriented White Papers to be widely disseminated and seeking to implement key policy recommendations.

The stakes are high: better corporate and public governance lowers the cost of doing business, improves the investment environment and leads to better institutions and higher, sustainable economic growth. We need to create incentives for good governance, rewards for integrity and ethical behaviour that are self-reinforcing mechanisms. One way is to publicly recognize firms implementing CG principles: the media have an important role to play in this context. We should also use the power and potential of modern ICT: create web links and networks of CG complying companies. International organizations actively engaged in promoting CG and business ethics, such as the OECD and the World Bank, should be pro-active in creating incentives o adopt CG, by creating National CG Gateways and networks.

Good corporate governance requires good political governance, and vice versa. Political and Public Governance and Corporate Governance must move in tandem to improve the business environment. As Juvenal asked: “Quis Custodiet Ipsos Custodes?” Who watches the Watchmen?

There is no better illustration than in the case of maximizing the potential benefits from the Lebanon-EU Association Agreement. The Lebanese corporate sector must invest for a ‘*mise à niveau*’ in order to compete in EU markets, which requires meeting EU product specifications and quality standards. More important we need corporate partnerships and joint ventures with EU firms. This requires implementation of CG principles, prudential standards and transparency in financial statements and accounts. Similarly, the Republic of Lebanon in its various manifestations and institutions will need to absorb the “*acquis communautaire*” of the EU, the laws, regulations, codes and standards that imply a harmonization with EU public governance standards, and which include CG principles.

Conclusions

Allow me to be old- fashioned and state that professional integrity and moral rectitude, accountability, transparency and virtue are rewarding in their own right: it is our moral duty to abide by professional ethics and seek to implement codes and standards that will advance the public good. We should advocate and implement business ethics and good corporate governance. The good news is that it is also in our selfish interest to do so!

Our generation –indeed several generations- have endured the inferno of violent conflicts, civil and uncivil wars and their bitter consequences for our economy and its institutions, for our social and political fabric and their foundations. We need to rebuild trust and confidence. We need to provide economic security for our children.
The thirteen years since 1991 have focused on the reconstruction of physical infrastructure, to the detriment of nation-building. However, the central issue is not reconstruction, but re-building the nation. Physical reconstruction, rebuilding destroyed infrastructure, is important, costly and takes time. But, the post-conflict countries like Lebanon and the ‘transition’ countries of the former Soviet block are discovering that building political infrastructure, restoring the social fabric and the infrastructure of economic governance, is more complex and important. The focus in Lebanon was on physical reconstruction, as though that were the avenue for nation-building. The result was failure in both physical reconstruction, which remains incomplete, and in nation-building.
To build a state, one needs to know what state to build: an agreement among partners and stakeholders leading to a stable, representative constitutional structure and an effective rules-based system of political governance that will ensure political stability. ‘Democracy’ and effective political representation, ‘voice, transparency and accountability’, should not be empty slogans. They cannot be imported; they have to be built by all the national stakeholders. The challenge is to break the web of mistrust spun during conflict. The challenge is to break out of the vicious circle of the conflict trap that gets created: the political leadership & organizations invest in skills specialized in and only relevant for conflict. Even language and vocabulary and political discourse get affected: ‘ كسر عضام جبهة صراع خصم معركة ”, elections and voting are described as ‘battles’ with ‘enemies’ whose ‘bones will be broken’.
We are trying to compete in an increasingly global business and policy environment and govern our economy while carrying the bureaucratic legacy and shackles of the Ottoman Empire and the additional ‘red-tape’ of the French colonial administration and the vested self-interest of political and commercial interest groups and elites. Do I need to remind you that it is only in 2001 that we removed the prohibition of dealing in gold imposed by the Mandatory power in 1941! We need to break the chains that are increasing the cost of doing business in Lebanon, encouraging the underground economy and acting against our national interest. This requires streamlining and minimizing administrative procedures, simplifying the tax system and introducing e-Government on a wide scale. Some progress has been made in customs and a limited number of administrative procedures, but we are far from the efficiency of governments like Singapore or Dubai.
I am now increasingly convinced of the important role that our domestic NGOs and civil society can play as agents for change and reform. Good CG comprises implementing laws and regulations, business ethics and creating a business environment that lead to a vibrant and profitable corporate sector and contestable markets. In turn this improves economic performance and leads to sustainable national economic development.
Today the RDCL has set the ball rolling towards rule-based, institutional behaviour, towards a transparent, accountable system of economic and political governance.
Thank you, and may we build a democratic and prosperous Lebanon for future generations.

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