PUBLIC-PRIVATE PARTNERSHIPS IN MIDDLE EAST DEVELOPMENT

The Challenge of Civil Society Engagement

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ABBREVIATIONS

CLT	Community Land Trust
CWRAS	Country Water Resource Assistance Strategy
DS	Dudley Street
DSNI	Dudley Street Neighborhood
GDP	Gross Domestic Product
GTZ	*Deutsche Gesellschaft für Technische Zusammenarbeit* (German Development Corporation)
HDI	Human Development Index
IBRD	International Bank for Reconstruction and Development
IHC	International Humanitarian City
IMF	International Monetary Fund
MEPI	U.S.-Middle East Partnership Initiative
NGO	Non-governmental organization
NWSA	National Water and Sanitation Authority (of Yemen)
NWSSIP	National Water Sector Strategy and Investment Program
PPP	Public-Private Partnership
Riley Foundation	Mabel Louise Riley Foundation
Sana'a Local Corporation	Sana'a Water Supply and Sanitation Local Corporation
UAE	United Arab Emirates
UN	United Nations

ABSTRACT

Public-Private Partnerships in Middle East Development:
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Alexandra De Vito, M.C.R.P.
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Over the past sixty years, the field of international development has come full circle, returning to priorities that value people over gross domestic product. Principles for successful development, such as institution building, managed competition to reduce corruption, human organization, the design of solutions to fit problems and social, political and economic stability, have also emerged throughout the international development literature. Building on this foundation, this book proposes the use of public-private partnerships as a tool for implementing development practice in the Middle East and analyzes the challenges that stand in the way of effective partnerships between governments and civil society.

PART 1.
GENERAL OVERVIEW

Chapter 1.

INTRODUCTION TO THE PROBLEM

International development is field that has been plagued by a mix of mostly unpredicted successes and failures. The field has progressed more by trial and error than by any sophisticated engineering. Emerging out of World War II's aftermath, the young international development institutions of the capitalist world, battling against communist aggression in poor defenseless countries, began eagerly supporting former colonies that had gained independence. Armed with economic models that were sure to work, these institutions fully expected to eradicate poverty, to establish global stability, and thereby make the world a better place.

Sixty years later, the international development community, after experiencing multiple failures of theory in practical application, has significantly evolved, having learned lessons and developed best practices. Its earlier self-assurance has been replaced by circumspection. Although the international development literature has come to advocate a more sensitive approach to development, focusing on people as the most important element of any development strategy, international development practice is still learning to implement development planning procedures that conform to this doctrine.

A series of recommendations for focusing on people as the center of development initiatives has emerged in the international development literature. These recommendations are widely agreed upon by practitioners, yet the international development apparatus has nonetheless been stuck halfway between entrenched procedures that reinforce statism and newer methods that focus on

empowering people. The standard procedures used in international development practice are slow to change from a top-down approach that reinforces statism to a bottom-up approach that empowers people.

Public private partnerships (hereinafter, "PPPs") are a flexible means of creating contractual agreements between public and private organizations. Although they are being widely used in international development practices, PPPs are more often oriented towards privatization within the international development context than towards empowering citizens.

This thesis proposes the use of PPPs in international development as a means of implementing the recommendations of international development literature, thereby advancing international development practice toward successful and responsible actions. After reviewing the literature supporting recommended principles for successful development in Chapter 2 and studying freedom as it relates to development in Chapter 3, the assumption that PPPs could be used in international development practice to implement literature recommendations will be tested by studying three public-private partnership cases in Chapter 4. These cases will be studied for how the partnerships implemented or did not implement recommended principles for successful development. Finally, in Chapter 5, the potential for PPPs as an effective tool in international development practice to implement successful development principles will be asserted, with a series of recommendations for their application.

Chapter 2.

DEVELOPMENT THEORY AND LITERATURE REVIEW

"The growth and development of people is the highest calling of leadership."
Harvey S. Firestone[1]

International development theory has moved full circle from the end of World War II to the late 1990s. In the early days after the War, development was directed in the Marshall Plan by business, academic, agricultural and private finance leaders. Yet what began as a process guided by a real understanding of problems and people eventually transformed into a mathematical formula for foreign aid input to economic growth output. By the 1950s, a new group of technocrats and economists in the Bretton Woods Institutions emerged as the leaders in development. The 1950s through the 1990s gave rise to a rapidly shifting and ever changing theories and development models, continually evolving to explain persistent poverty in light of numerous economic failures. These failures eventually gave way to the return of process-oriented development, where the concept of GDP has been replaced by the concept of people, a change that represents a significant advance for humanity.

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[1] American industrialist founder of the Firestone Tire & Rubber Co., 1868-1938.

2.1 The Marshall Plan

At the conclusion of the Second World War, in 1945, Europe was in physical and economic ruin. Whatever industrial equipment had survived the destruction of the war was antiquated. Industrial manufacturing had come to a complete halt. While there was an abundance of overvalued European currency, there was little to buy. This led to extreme inflation and, subsequently, to the hoarding of gold and dollars. Farmers in Italy and France were growing less than fifty percent of their normal crop because there was no incentive to sell crops for money when there was no farming equipment available for purchase.[2] By 1947, Europe was on the brink of starvation.

Although the United States had already spent an estimated $9 billion between 1945 and 1947 in food through the United Nations, the situation in Europe was not improving.[3] It became apparent to some in Washington, as expressed by Secretary of State George Marshall in his Harvard University commencement address on June 5, 1947, that the United States should take an active role in restoring political stability to Europe by pursuing comprehensive economic reconstruction.[4] Following a great

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[2] Dulles, Allen (1994) *The Marshall Plan*. Berg Publishers.

[3] *Ibid.*

[4] "It is logical that the United States should do whatever it is able to do to assist in the return of normal economic health in the world, without which there can be no political stability and no assured peace. Our policy is directed not against any country or doctrine but against hunger, poverty, desperation, and chaos. Its purpose should be the revival of a working economy in the world so as to permit the emergence of political and social conditions in which free institutions can exist. Such assistance, I am convinced, must not be on a piecemeal basis as various crises develop. Any assistance that this Government may render in the future should provide a cure rather than a mere palliative. Any government that is willing to assist in the task of recovery will find full cooperation, I am sure, on the part of the United States Government."
Taken from Speech Delivered by General George Marshall at Harvard University on June 5, 1947. Modern History Sourcebook, Nov. 09, 2008, available at http://www.fordham.edu/halsall/mod/1947marshallplan1.html.

campaign aimed at converting Congress and ensuing visits to Europe by over two hundred members of the Senate and the House, legislation approving the first year of the European Recovery Program was passed into law by December of 1947.

The European Recovery Program, which would later come to be known as the "Marshall Plan," focused on the people of Europe as the source of their own hope. If the threat of famine could be eliminated, then European society could convert itself into a system of production, positioning itself to return as an active member in the global economy. Within the context of this focus, or "theme," the Marshall Plan had four main goals: (1) to bring humanitarian aid to Europe and to halt starvation; (2) to help Europe recover so that it could purchase American goods; (3) to contain communism; and (4) to demonstrate that free, open economies work. Before reviewing the details of how these goals were met, it is important to understand what was perceived as the problem behind Europe's troubles.

It was no secret that President Truman held opposed colonialism.[5] He actively promoted a policy of encouraging Europe to free all of its colonies, which were considered to be the source of inter-European wars. Europe had long been dominated by nationalism and had overemphasized sovereignty relative to economic efficiency. For example, European nations, rather than trade with one another, frequently traded with only their respective colonies. Resulting from American fatigue of European wars that stemmed from an overemphasis on sovereignty, the Marshall Plan sought to create economic interdependence by promoting intra-European trade, such that future wars in Europe would be rendered impossible.

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[5] McKinzie, Richard D. 1974. "Oral History Interview with John Wesley Jones." Harry S. Truman Library & Museum, Nov. 9, 2008, available at http://www.trumanlibrary.org/oralhist/jonesjw.htm.

The Marshall Plan thus made European nations less dependent on their colonies and more dependent on one another through trade. Changes in trade patterns and tariffs were central to the requirements of the Plan, which responded directly to the perceived root cause of wars in Europe by redesigning the economic system by which intergovernmental relationships were forged. Although the Plan had many goals, this systemic change built from Europe's existing capacity for economic production persisted as a thread throughout the implementation of the Plan and the realization of its goals.

As the United States began considering the challenges of reconstruction, three criteria emerged for evaluating potential strategies: (1) the capability of the United States to contribute resources without stunting its own capacity for economic growth;[6] (ii) the European situation as assessed by independent American sources; and (iii) how the United States could most effectively administer aid to maximize assistance in Europe while protecting the American economy.[7]

It was decided that first, the most urgent and basic need in Europe, food, would be exported to avert the starvation crisis. Second, incentives were created for European farmers to boost food production, which presented a more sustainable solution to the food shortage. Once the foot shortage was curbed, urban Europeans could move into industry, producing their own goods and services and rebuilding their own economies. It was also important that the currency be stabilized to stop inflation, which was imperative in creating a climate for investment and growth.

The Plan eventually evolved into two programs: (1) the emergency aid program; and (ii) the reconstruction and capital goods program. The former provided grants, while the latter

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[6] It should be noted that the total United States contribution equaled $22 billion over a four year period, which was less than three percent of the United States national income during the lifespan of the program.

[7] Dulles, Allen (1994) *The Marshall Plan*. Berg Publishers.

provided capital goods via loans. The items slated for grant status were goods that are rapidly consumed. Additionally, the determination of what would be supplied through a grant versus a loan depended upon each individual country's ability to repay and the effect of dept accumulation on its recovery.

In the emergency aid program, primary United States assistance was given to the agricultural sector in food to feed the farmers and stabilize the currency, encouraging the farmers to sow their seed and not to eat it. Food, fuel, and fertilizer, which made up seventy percent of the total aid provided, were provided in the form of grants. The provision of tools to help Europeans to increase their own production of food, fuel and fertilizer was also in the form of grants. All aid was provided in-kind rather than in cash, since: (1) dollars were useless for food; and (2) the United States, by purchasing American goods for export to Europe, benefited its own economy while avoiding competition from foreign countries.

The reconstruction and capital goods program (the second program of the Marshall Plan), provided loans only for capital and commodities that would directly increase productivity and create the means by which the loans would be repaid. Consequently, the industrial sector was mostly rebuilt through loans. In rebuilding the European industrial sector, private American business played a substantial role relative to that of the American government, whose intervention was limited. Many American businesses gave machinery and needed capital to rebuild European factories through partnerships, whereby American businesses would then own part of the European counterpart. Most of the capital was provided through loans that were managed by either the World Bank, the Export-Import Bank, or by private institutions. Intergovernmental loans were avoided under the reasoning that the loan should be handled by one of the above-mentioned institutions, "if the credit of the borrower [was] good enough to justify calling for repayment in dollars."[8] In order to encourage private capital,

[8] Dulles, Allen (1994) *The Marshall Plan*. Berg Publishers.

the federal government set aside dollars to cover any costs incurred in transferring a debtor's assets into dollars; however, the government was not to underwrite the ordinary risks of business.

The implementation of the Plan was perhaps the strongest means of restructuring the economic system of Europe from colonialism to regional interdependence. The sixteen nations that participated in the program agreed to commit themselves to: "(1) the creation and maintenance of internal financial stability; (2) the development of economic cooperation to bring production to the specific targets, especially in the cases of food and coal; (3) cooperation in the reduction of tariffs and trade barriers; and (4) organization of the means by which common resources can be developed in partnership."[9] The participating nations were required to submit their deficits and then to coordinate amongst one another as to how they would help each other before the United States would provide assistance. For example, Italy, which might have had an excess of vegetables, but a shortage of coal, could trade with Germany, which might have an excess of coal, but no food. From this emerged the Organization for European Economic Co-operation, which provided the organizational vehicle for all sixteen participating nations to negotiate and prepare a plan for their own recovery. American aid would only be provided once this plan had been coordinated. This created the institutional framework for managed competition.

Additionally, participating nations were required to "deposit in a special account the amount of local currency equivalent to the aid furnished in the form of grants."[10] These deposits would be used in a manner mutually agreed upon by the United States and the country concerned. These countries were also to provide full information regarding how the aid was put to use, establishing the pattern for public open transparent regulation.

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[9] *Ibid.*

[10] Dulles, Allen (1994) *The Marshall Plan*. Berg Publishers.

Even with all of these conditions, the United States retained the right to discontinue assistance at its sole discretion.

In considering the unique aspects of the Marshall Plan, it might be worth mentioning that George Marshall never planned the reconstruction of Europe. Rather, he proposed a process by which the participating European nations planned their own economic recovery. What is also unique about the Plan is that it responded directly to real problems with the comprehensive approach of a designer rather than with a model copied from an abstract theory. The problem of eliminating future European wars was addressed by altering the system by which the relationships among the European nations were created. The problem of starvation, inflation, and economic recovery were addressed by a multi-phased process of first providing food for people in the form of grants, then providing grants for agricultural production equipment, and third, providing industrial capital goods in the form of loans after currency stabilization took place.

Another unique aspect of the Plan is that it created an economic incentive for people to organize themselves and to coordinate their respective activities. The United States did not coordinate this organizing; it merely provided the carrot by promising aid once all parties had negotiated an agreement. The coordination and competition created among the donees necessarily created a system of checks and balances in authenticating each nation's statement of need and their proposed allocation of United States aid. The possibility of corruption was further repelled by requiring public open transparent disclosure in how the aid was used. At the time of the Marshall Plan, Europe had a significant level of human capital. The Plan relied completely on the people of Europe to make reconstruction a success, and there are few who would say it did not meet its goals.

2.2 Establishment of the Bretton Woods Institutions

At the same time that Europe was entering the last nine months of World War II, a new global system of monetary management was being established in Bretton Woods, New Hampshire. While the express purpose of the Bretton Woods Agreement was to require signing nations to regulate the exchange rate of their currency to facilitate the stability required for free trade, it also gave birth to two institutions that have become the hope and disappointment of international development: the World Bank and the International Monetary Fund (hereinafter, "IMF"). The IMF's original mission was to ensure global economic stability by pressuring countries that were not "doing their fair share to maintain global aggregate demand, by allowing their own economies to go into a slump."[11] The IMF, when necessary, would also provide liquidity in the form of loans to those countries that, due to economic downturns or crises, were unable to stimulate aggregate demand with their own resources.

The World Bank Group was originally one bank known as the "International Bank for Reconstruction and Development" (hereinafter, "IBRD"). It has since grown to a group of five institutions, of which IBRD is a member. The purpose in creating the bank was to finance the reconstruction of Europe. However, the young institution did not have the credit resources to deal with the magnitude of Europe's reconstruction. Additionally, the IBRD bonds could only be sold on Wall Street, as it was the only market available for such bonds. At the time, conservative Wall Street banking forced the IBRD to behave likewise and only grant loans when repayment was guaranteed. The Marshall Plan eventually addressed the issue of Europe's reconstruction, mostly through grants. Since the original mission of the IBRD was never realized, it

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[11] Stiglitz, Joseph E. 2003. *Globalization and Its Discontents.* W. W. Norton & Company.

has since shifted its mission to fight poverty by financing governments.

2.3 Survey of Development Theory and Strategies Since the Marshall Plan

After the establishment of the Bretton Woods Institutions, the face of international development changed. The institutions that came to take a central role in development—the IMF and the World Bank—were dominated by economists, whereas the earlier Marshall Plan was spearheaded by a diverse committee that included representatives from steel and agriculture organizations; synthetic rubber, shipping, and coal interests; private foreign exchange and international investment banks; skilled labor; the Federal Reserve Bank; policy experts; and electric, chemical, automotive, and academic organizations.[12] It is no wonder that for forty years, between the end of the Marshall Plan and the early 1990s, international development has been conducted by technocrats armed with theories that are yet to produce a case as intensely successful as the Marshall Plan.

In this section, a survey of the development theories that have characterized the international development field from the 1950s to 1990s will be presented.

2.3.1 Forced Savings

Forced savings was first articulated by Henry Thornton in 1804. At around the time of the Second World War, it reentered modern discussion of economic theory among economists such as John Maynard Keynes[13] and Ludwig von Mises.[14] The theory held that people are more likely to consume their income and cannot be

[12] Dulles, Allen (1994) *The Marshall Plan*. Berg Publishers.

[13] Keynes, John Maynard. 1940. *How to Pay for the War*. London

[14] Mises, Ludwig von. 1934. *Theory of Money and Credit*. London.

trusted to invest. Therefore, forced suppression of consumption produces forced savings that ultimately can then be invested.

Government may suppress consumption by increasing inflation by means of printing more money and shifting resources away from consumer goods production (thus lowering quantities), which increase the prices of consumer goods. With newly printed money, the government may invest in capital goods. The new money causes higher prices and consequently, households can no longer consume the same amount of goods. The result is suppressed consumption, forced savings and investment in the form of capital goods.

Governments might also pursue a tax policy that reflects the assumption of forced savings economic theory that people cannot be trusted to invest. Thus, the government suppresses consumption through high taxes, which restrict income in order to force the transfer of savings into the government's control. Government then takes upon itself the burden of investing on behalf of society.

One criticism of forced savings is that inflation disrupts society and the burden of inflation is not evenly shared. After World War II, many less developed countries in Latin American applied forced saving policies in order to finance economic development.[15] Unfortunately, the policies were not successful in creating economic development, as the savings were often invested in speculative real estate or some other type of investment with no real value to society. A second criticism is that if the private sector cannot produce the entrepreneurship to invest, there is very little reason to believe the public sector will. A third criticism is of the basic assumption that in order to stimulate investment, consumption must be suppressed. This third criticism suggests that consumption is actually a form of investment in production. The most simplistic example is that the consumption of food is an investment in the productivity of the physical body.

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[15] Harris, Seymour Edwin. 1972. *Economic Problems of Latin America.*

2.3.2 Take-Off Theory

Walt Whitman Rostow, an American economist, first published his take-off theory for economic development in 1956. He proposed that nations develop in a predictable pattern. First, certain preconditions exist where physical and institutional infrastructure is built up to support investment and growth. Second, the economy is suddenly stimulated into a take-off period by some intervening factor, such as a political revolution or a change or improvement in technology or production processes. Third, the economy endures a take-off period, whereby: (a) the rate of savings increases from five to ten percent; (b) one or more substantial manufacturing sectors develop with high growth due to domestic demand; and (c) there is a rapid expansion of political, social and institutional frameworks to take advantage of the stimulus and to mobilize capital. Finally, the national savings rate increases to more than ten percent and the economic growth and development is self-sustained.

Some of Rostow's assumptions regarding savings, investment and capital follow narrow definitions. According to Rostow, capital includes only three types of assets: (1) housing; (2) manufacturing plants and office buildings; and (3) major machinery or equipment. Investment is capital formation, which is the production of the above-listed forms of capital. Rostow did not view land as an investment. He assumed, rather, that investment occurred through such institutions as banks and stocks.

In analyzing the stages of economic development presented in his take-off theory, Rostow proposed that the vanguard, professional elites, not traditional elites concerned with preserving the status quo, cause the take-off, since they are more likely to be productive with capital. Consequently, he argues that the government should invest in the creation of a vanguard elite that can transform economies.

The primary critiques of Rostow's theory come from economic historians who argue that societies have always been

characterized by both traditional and vanguard elites, which suggests that the existence of a entrepreneurial (vanguard) elite is not the magic key to economic transformation. Rather, proper infrastructure is more crucial to economic growth because without it, economic growth is unsustainable. They also argue that growth has been happening long before the industrial revolution. They question Rostow's urban bias by excluding land in his definition of capital and his assumption that development is always marked by industrialization and manufacturing. They also criticize his theory for promoting international development policies that were insensitive to cultural differences in assuming both a western industrial model of development and a vanguard elite with western ideals as universal.

2.3.3 Comparative Advantage

Comparative advantage theory grew as a major economic policy for development in less developed countries after World War II. The classical comparative advantage and trade theory of Adam Smith and David Ricardo holds that the growth of a national economy will accelerate on the specialization of productions and trade on which the nation has a comparative advantage. The classical comparative advantage theory assumes that only labor creates value and that all factors of production in the domestic economy are perfectly mobile and in perfect competition. The modern version of the comparative advantage theory, as it was conceived by Eli Heckscher and Bertil Ohlin in 1933, converted all aspects of the classical growth theory to cost.[16] The new theory revised the assumptions to include both labor *and* capital as factors that create value, and assumed that the basis of production, specialization and trade were production cost and opportunity cost.

Although the Smith-Ricardo classical growth theory of comparative advantage remains applicable to development

[16] Chenery, H. B. 1961. Comparative Advantage and Economic Policy.

strategies, the Heckscher-Ohlin model does it. It is merely a mathematical formula that nonetheless was applied in economic policy in the 1960s in less developed countries. This latter model of comparative advantage suggested that the advantage in trade lies in the cost of labor: if a nation had low cost labor in one sector, it should export goods produced by that sector; but if it had a high labor cost in a sector, it should import products of that sector. Once it could be determined from past production costs which country could produce certain items at a lower cost than others, relative ratios of productivity could be compared to determine how to reach maximum global productivity for the same cost. This information could then be used to inform resource allocation decisions to build up certain sectors in specific nations.

The main critique of applying the Heckscher-Ohlin model to economic development policy is that it suggests developing a central planning agency to run the global economy using its maximum productivity charts as the basis for who receives investment. This would disrupt the existing social, economic and political order. Another critique is that by basing the cost comparison ratios on past production costs, it does not reflect real life future risks, which should temper resource allocation decisions. Another critique is that the conversion of the classical comparative advantage theory into a model of costs, where labor is a measure of cost, reflects an industrial urban bias. A farmer's labor is not counted in the Heckscher-Ohlin model. This new model of comparative advantage, particularly when applied to economic development policy, has notably departed from the classical Smith-Ricardo growth theory.

2.3.4 Gap Financing: Harrod Domar Growth Model

The Harrod Domar growth model was developed independently by Sir Roy F. Harrod in 1939 and Evsey Domar in 1946. Without getting into the details of the calculations, the model suggests that output (or income) is a function of capital. It predicts

that the output over a period of time will be the previous year's net investment in GDP, or that GDP growth will be proportional to the share of investment spending in GDP.

This model was applied to development policy as a means of justifying foreign aid investment. The model suggests that growth is a factor of investment, but development experts usually discussed it in terms of how much investment is required to meet a *desired* level of growth. The Incremental Capital Output Ratio (ICOR) represents the ratio of required investment to desired growth for a particular country. For example, if a country has an investment rate of four percent, and an ICOR of four, then its investment rate of four dividing by the ICOR ratio of four predicts that growth will be one percent, which would not keep up with a population growth rate of two percent. If the target economic growth rate is three percent, then the gap in investment is equal to eight percent.[17] In an environment of heightened Cold War fears, wealthy capitalist nations were persuaded to finance the investment gap in poor nations. This gap financing model was in competition with Soviet foreign investment raised through forced savings.

The Harrod Domar model fell out of fashion to the Solow growth model in the 1970s and 1980s because it had not produced the economic growth that it predicted. Critics argued that resource *allocation* was more important than resource quantity. However, counterarguments supporting the use of the model continued through the 1990s, suggesting that gap financing was *necessary* though not *sufficient* for economic growth.[18]

Those who oppose any use of the model argue that the idea that there is a ratio of input to output is not based on reality. It is inconceivable that an entrepreneur could run a business using a model of input-output ratios, considering there are multiple factors

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[17] Easterly, W. 1997. The Ghost of Financing Gap: How the Harrod Domar Growth Model Still Haunts Development Economic.

[18] *Ibid.*

significant to growth which are not included in the model, such as human capital. Other critics have pointed out that gap financing puts money into the problem without really understanding the problems in a country. Perhaps one country requires machines and another requires cell phone technology. This approach to development provides money to governments, suggesting that private sectors lack the skills to invest resources successfully. As a final criticism, the model does not recognize the importance of institutions to sustainable growth.

2.3.5 Surplus Labor

In the 1950s, Sir William Arthur Lewis proposed a return to the classical labor surplus model in pursuing development strategies in less developed countries. Marxist economics define surplus labor as labor that is unpaid or uncompensated by a wage. This is the source of the capitalist's profit. The classical labor surplus model developed during the first industrial revolution in the eighteenth century, as the migration of labor from the rural agricultural sector to the urban industrial sector resulted in economic growth.

Since agriculture is seasonal, surplus labor theorists assumed that people in the agricultural sector only work seasonally and remain unemployed for over fifty percent of the year. The wages of a farm hand were considered greater than the marginal return for his labor because he was doing nothing productive during most of the year (this is termed, "disguised unemployment"). The classical labor surplus model assumed that the elastic flow of unemployed labor from the countryside to the cities maintained stable low wages for factory workers. Stable low wages, a result of elastic labor, produced a labor surplus, resulting in higher profits for capitalists.[19]

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[19] Williamson, Jeffrey G. 1985. The Historical Content of the Classical Labor Surplus Model.

Lewis' return to the classical surplus labor model was propelled by development economists in the 1950s and 1960s. If the disguised unemployment in the agricultural sector could be transferred to year-round full-time employment in industrial factories, it would propel the economy into accelerated growth. It would also induce greater efficiency into the agricultural sector while maintaining low wages in the industrial sector, increasing capital and overall economic growth. This encouraged disinvestment in agriculture, which was perceived as inefficient, and encouraged new investment in industry.

Governments applied this theory to policy through price controls. They would control the market by purchasing food from farmers at low prices and selling the food to the urban population at market price. The profit often amounted to a tax of nearly fifty one percent on the production of farmers. This profit was in turn used to fund the expansion of the industrial sector. The government would squeeze the farmers and push migration from rural areas to urban centers.

The critique of the application of the surplus labor model to development policy is that it failed to understand agrarian economics. Farmers do not always concern themselves with increasing profits; rather, they focus on reducing costs. If they can produce something themselves for less than they can purchase it, they will. Furthermore, what has been perceived as seasonal unemployment in the agricultural sector by economists with an urban bias is often a time of investment in the farm. During off-seasons, machinery is mended, irrigation systems are repaired, and other forms of preparation for more active seasons in farming are conducted. Additionally, it has been proven that more labor in the agriculture sector results in higher productivity.[20] Labor is critical to the harvest and planting seasons. If labor is encouraged to

[20] Ranis, Gustav. 2004. Arthur Lewis' Contribution to Development Thinking and Policy. Yale University, available at http://www.rh.edu/~stodder/BE/Lewis_byRanis.htm.

migrate to the industrial urban centers, it may result in lowering agricultural productivity and may force the government to import food that was once domestically produced. The increase in industrial production is countered by a decrease in agricultural production and does not produce overall economic growth, as the theory suggests.

Critics of the surplus labor model also contend that real development involves a division of labor, where urban labor is interdependent with farmers and other rural labor. Agriculture is freed by technology, allowing those who would have worked on the farm to be free to work in industry, manufacturing the technology that farmers are using to replace labor. While it is a concern that work once realized by people is now realized by machines running on petroleum and other non-renewable resources that will become depleted, the division of labor is a mark of real development, and is contrary to the surplus labor model, which suggests that agriculture has embedded within it hidden unemployment.

2.3.6 Washington Consensus

More commonly know as "Reaganomics," the Washington Consensus represented a major shift in policy for both domestic and international development in the 1980s. By this point in history, many central planning strategies had failed to reduce global poverty. With the evidence that China provides, we now know that central planning in itself is not the source of these failures. The recent credit crisis of 2008 in the United States similarly shows a market failure where government intervention cannot be blamed, since the government only intervened after the crisis in mortgage-backed securities arose. However, it was the economic development strategies prior to 1980 that promoted government intervention in markets *through price controls* and suppression of market demand (such as in the extreme case of the Soviet Union, though many capitalist nations also followed these

growth strategies) that had destroyed competition and efficiency, and had failed to produced economic growth.

This set the stage for the three pillars of the Reagan-Thatcher Washington Consensus: privatization, liberalization, and macrostability. Privatization is based on the principle that market forces are better at providing certain goods and services than can the government, which should instead focus its attention on its essential functions without being sidetracked with tasks that are more efficiently executed by the private sector. Liberalization, a direct reaction against central planning and government interventionist policies, discourages any government intervention in financial and capital markets through trade barriers and other regulations. It is based on the idea that capital should flow freely within and between countries and governments should allow market forces to regulate themselves. Macrostability seeks to create the right environment for foreign investment through currency exchange and controlling for inflation.

These policies brought a mixture of success and failure to economies around the globe. The central critique of the Washington Consensus aims at its poor implementation record. The Structural Adjustment Programs of the IMF, which were meant to establish the climate for growth for nations in economic crises, painted a picture of how things *ought* to be without planning for how a country would transition smoothly to that end. For example, if a government was subsidizing an inefficient nationalized industry, it was told to sell it off to the private sector. There was no thought given as to whether sufficient regulatory institutions and laws, such as anti-trust laws or environmental protections, were in place to protect the public. There was furthermore no transparency or oversight for assuring the national industries were not sold below cost to friends and supporters of those who held political power.

In the Washington Consensus model, nations were ordered to open up their financial markets so that foreign capital could be freely invested therein. The principle of open financial markets

might seem like a means of encouraging investment and economic growth, but the details of how a nation with closed financial markets transitioned to open markets made the difference as to whether the principle actually worked. In many instances, when a nation's financial markets were suddenly opened, they attracted a great deal of short-term capital investments that were speculating on changes in currency values. The net effect of these short-term capital investments, which were quickly withdrawn from local economies, was to destabilize financial market and to thus discourage the long-term capital needed for development strategies with long gestation periods.

Countries were also ordered to remove trade barriers and tariffs. When poor nations without strong export industries opened their doors to free trade, their domestic markets were inundated with imports, making it all the more difficult for domestic industry to compete. At the same time, the developed world did not follow its own advice in removing tariffs and other barriers to trade. Certain domestic products in the developed world, such as agriculture, continued to receive heavy subsidies, making it even more difficult for less developed countries to compete. Furthermore, trade barriers were typically implemented by developed nations when they were first developing new industries during the Industrial Revolution. If the less developed countries followed the example of the developed world, they would first strengthen their domestic production and then remove barriers to trade only when their own industries were strong enough to handle foreign competition,.

The inattention to *pace* and *sequencing* in implementing these changes in economic policy was responsible for creating much social, economic and political instability.[21] Without stability, development is virtually impossible, as was proven through the years following the fall of the iron curtain. The World Bank and the

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[21] Stiglitz, Joseph E. 2003. *Globalization and Its Discontents.* W. W. Norton & Company.

IMF pursued a policy of economic reform in the former Soviet Union and Eastern Europe known as *Shock Therapy*. The sudden shift from a central planning to a free market economy did not begin to produce economic growth until almost fifteen years had passed and life had returned to some measure of stability. Rather, these nations first fell into deep recession, with human conditions significantly worse than under the broken communist system. No thought was given to those who had to live during the transition from central planning and closed markets to privatization and liberalization.

2.3.7 Development as a People-Oriented Process:

Since the failures of international development in the 1980s and 1990s, renewed attention has been given to the *process* of development planning as it affects real people over strategies that represent an abstract end-state economic condition. The World Bank has even developed a Participation and Civic Engagement Group to "promote the participation of people and their organizations to influence institutions, policies and processes for equitable and sustainable development."[22] It has discovered that local participation in project selection and design is more likely to be successful. This has been joined to the idea that *democratic* processes produce better projects.

The World Bank has gone as far as developing special grant programs for communities to spend as they see fit. This is a remarkable departure from the development tactics applied by the Bank from the 1950s through the 1990s. While there have been a few cases of grant monies being misspent, the World Bank grant programs have experienced overall success, to the point of being imitated by several countries, such as Thailand. The arguments

[22] *Participation and Civic Engagement*. The World Bank, November 12, 2008, available at http://www.worldbank.org/participation.

supporting these programs focus on those factors that made the Marshall Plan such a success:

> [T]he people in the village know better than anyone else what will make a difference to their lives; they know how the money is spent, and any corruption hurts them directly. Having invested in the planning and execution of a project, they are more likely to feel ownership, a commitment to see it through to success, and therefore more likely to see it receive the funds required to maintain it.[23]

The elements at work in this kind of a development approach are as follow: (1) managed competition among donees, which makes corruption more difficult); (2) human organization and cooperation before funds are granted, making the project more sustainable by building the institutions required to manage the future project into the planning phase; (3) providing grants rather than loans; (4) project planning by those most affected by the project; and (5) solutions that are tailored directly to problems. This approach to development has become synonymous with *building democracy* because it encourages civil society to strengthen itself and to participate in processes that were previously handled exclusively by governments.

However, it should be noted that public participation in development planning is not identical to "democracy" *per se*, which is a political system of both shared power and electoral processes. Rather, the participation approach to planning places people at the center of development by including them in the planning. This is more fundamental to the success of development projects than whether the project takes place in a country with a democratic political system.

The United Nations came to recognize the value of people in measuring development at about the same time as the World Bank. Previous United Nations measures had either directly or indirectly relied on national GDPs as a measure of development. In the early

[23] Stiglitz, Joseph E. 2006. *Making Globalization Work.* W. W. Norton & Company.

1990s, the United Nations switched focus and began systematically relying on the Human Development Index (hereinafter, "HDI"), which includes measures of human life expectancy and educational attainment combined with measures of income. Economic resources are viewed as a means of improving human well-being—not as the goal of development.

Urban Planning in the United States and the United Kingdom has recognized the significance of *processes* in city planning since the 1950s Rational Planning Model was developed. Yet international development theory, recognizing development as an end-state condition rather than as a process, has been slower to catch on. Perhaps the difference in scale between urban planning and international development produced this discrepancy: whereas urban planners are concerned with local economic development, international development is often concerned with growth in national economies, which are intimately tied to the people affected. Whatever the reason for the delay in international development theory, there remains great potential in considering how the lessons learned in urban planning can be applied to international development.

2.4 Public-Private Partnerships in International Development

Public-Private Partnerships emerged with great popularity in international development under the Washington Consensus mantra of privatization. A PPP is a contract between a public and a private organization. For example, a public bureaucratic agency may enter into a contract with a private janitorial services company to maintain the agency's office facilities. Similarly, a government may sell a nationalized industry to a private sector, which will thereafter handle the provision of some public good to the general

population. PPPs are often narrowly conceived to be limited to one of the following types[24]:

Type	Asset ownership	Maintenance	Investment	Duration
Service contract	Public	Public/private	Public	1-2 years
Management contract	Public	Private	Public	3-5 years
Lease	Public	Private	Public	8-15 years
Build, operates, transfer	Private	Private	Private	20-30 years
Concession	Public/private	Private	Private	25-30 years
Divestiture	Private	Private	Private	Indefinite

Just as many of the privatization strategies of the 1980s and 1990s under the IMF's Structural Adjustment Programs were not successful in bringing sustainable economic growth and well-being to the majority of society, so PPPs do not have a solid record of success within the international context. It should be noted that because a PPP is a legally binding agreement, certain legal frameworks must exist in order for the agreement to be enforceable. It is extremely important to have a judicial system independent from any other governmental branches. A private party who signs a contract with a government must have the assurance that if the

[24] Table taken from: Sahooly, Anwer. "Public-Private Partnership in the Water Supply and Sanitation Sector: The Experience of the Republic of Yemen." *International Journal of Water Resources Development* (Routledge, June 2003).

government does not complete its legal obligations, the private party has legal recourse by which to enforce the terms of the contact. All the same, PPPs remain a favored development tool of the IMF[25] and of the United Nations Development Programme.[26] The World Bank has considered privatization through PPPs to be a central strategy in achieving economic reform in less developed countries in order to promote private investment, create jobs, develop a middle class, shift risk from the public sector to the private sector, and reduce capital flight abroad.[27]

Although PPPs are extremely flexible and can adapt to any terms of negotiation, they are still entrenched in privatization ideology within the international development community. They are viewed as a means of bringing economic reform, as prescribed by the Washington Consensus. However, because of their flexible nature, they nonetheless have the potential to serve as a means of applying development principles that favor civic engagement and participation in development planning. The success of PPPs will depend on their inclusion among the fundamental principles of successful development, which include human organization, managed competition, institution building, the design of solutions to fit problems, and social, political and economic stability.

After all of the theoretical movements that international development has endured since the end of World War II, the future development of the globe still remains uncertain. International development is very difficult to achieve and it takes a long time. Stories of failed policies are more prevalent than those of successful

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[25] Gerrard, Michael B. "Public-Private Partnerships." *Finance and Development: A Quarterly Magazine of the IMF* (International Monetary Fund, Sept. 2001).

[26] *Special Unit for South-South Cooperation.* United Nations Development Programme, November 12., 2008, available at http://www.ncppp.org/undp/index.html. (showing that PPPs are utilized as a tool for reaching development objectives by the Special Unit for South-South Cooperation of the United Nations Development Programme).

[27] Guislain, Pierre. *The Privatization Challenge: A Strategic, Legal, and Institutional Analysis of International Experience* (World Bank, 1997), p. 18-19.

policies. Despite this great challenge, there remains a small hope that the international development community has moved beyond over-simplistic models and is beginning to embrace the complexity of each individual as a contributor to the success or failure of his or her nation in the new era of globalization.

PART 2.
Studies within the Middle Eastern Context

Chapter 5.

YEMEN: THE WORLD BANK'S PPP INITIATIVES IN THE WATER SECTOR

5.1 Overview

It is widely recognized that the water situation in Yemen borders on crisis. Not only is water being pumped out of the ground at an estimated 138 percent of the annual renewal rate, but both urban and rural water delivery and sanitation are below international standards.[54] Near the capital city of Sana'a, the water basin is currently experiencing an overdraft of 150 percent, with the water table dropping by seven meters per year.[55] Ta'iz, the third largest city in Yemen, also has extreme water shortages. Yemen has engaged multiple strategies for tackling the pending water crisis, including restructuring the urban water sector with the goal of privatization through PPPs. After nearly a decade of reform in the water sector, a PPP was finally signed in Ta'iz in 2006, though not in Sana'a.

Yemen is one of the world's least developed nations. In 2004, it ranked 149 out of 175 countries on the Human Development Index. It has an economic growth rate of 3.461 percent, but a population growth rate of 6.7 percent. With an unemployment rate

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[54] *Yemen Country Profile: Natural Resources*. United Nations Development Programme, Yemen, 30 Oct. 2007, available at http://www.undp.org.ye/resources.php.

[55] Sahooly, Anwer. "Public-Private Partnership in the Water Supply and Sanitation Sector: The Experience of the Republic of Yemen." *International Journal of Water Resources Development* (Routledge, June 2003).

of 35 percent and inflation at a stifling 20.8 percent, one in five people are malnourished.[56] Part of the challenge in raising the development level in Yemen is that its population is mostly rural, and is therefore spread-out geographically. Another challenge that faces Yemen is the production and consumption of qat, an addictive stimulant grown domestically. It is estimated that 90 percent of all water consumption in Yemen is by the agriculture sector. While the plant is a productive cash crop for farmers, it requires a lot of water to grow, exacerbating the water shortage in the country. Additionally, up to three quarters of the adult population spend one-quarter to one-third of their income on qat. People spend several hours each afternoon sitting together chewing the leaves of the qat plant.[57] It is difficult to get farmers to switch to food crops when qat receives a higher price in the market.

As of 2002, the domestic water service covered about only forty percent of the urban population and thirty percent of the rural population.[58] The rest of the population either collected water from private wells or mosques or purchased water from trucks that brought it from the rural areas into the city. The management of water consumption and water rights has remained one of the largest challenges in meeting the pending crisis in Yemen. In some regions, water has been considered a free public resource. In other areas, rights to water have been negotiated between tribes over centuries. Up until 2004, there were no restrictions or permits required for the construction of private wells. However, with the

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[56] *Yemen.* World Bank, November 14, 2008, available at http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/YEMENEXTN/0,,menuPK:310170~pagePK:141159~piPK:141110~theSitePK:310165,00.html.

[57] Milich, Lenard and Mohammed Al-Sabbry. 1995. *The "Rational Peasant" vs Sustainable Livelihoods: The Case of Qat in Yemen.* The University of Arizona.

[58] Sahooly, Anwer. "Public-Private Partnership in the Water Supply and Sanitation Sector: The Experience of the Republic of Yemen." *International Journal of Water Resources Development* (Routledge, June 2003).

overdraft of groundwater by farmers, water resource management has become an imperative for the greater good of the public. The track record of urban water management has not been very good either. For example, in 1999, in Sana'a, over fifty percent of domestic water consumption was unaccounted for and revenue for this water was uncollected.[59]

The World Bank, which has been involved in Yemen since the 1970s, has continued to consult the fledgling government after unification in 1990, especially during the process of liberalization and reform in the 1990s, when it provided expert consultation via the International Development Association. Although the World Bank had recognized that groundwater in Yemen was being depleted as early as 1968, it was not until 1992 that the Bank made its first attempt to address water as a diminishing resource requiring management. The Land and Water Conservation Project began in 1992 and ended in 2000. The goal was to improve irrigation technology in rural Yemen. Overall, the project was successful, as the Yemeni government has continued the program after the World Bank completed their involvement. [60]

In 1995, as the water crisis in Yemen moved to the forefront of the international donor community's agenda, the Multi Donor Group for Yemen Water was formed with the United Nations Development Programme, the Netherlands, and the World Bank as principle members.[61] It was agreed that a coordinated approach to the water problem would produce the best results without duplicating efforts. That same year, the government of Yemen passed a decree to create the National Water and Sanitation Authority (hereinafter, "NWSA").[62] After years of trying to work

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[59] *Ibid.*

[60] *Project Performance Assessment Report: Yemen.* World Bank, Feb. 2006, Report No. 35004.

[61] Dervis, Kemal et. al. Yemen - *Toward a Water Strategy: An Agenda for Action* (World Bank, Aug. 1997).

[62] *Ibid.*

with the former dispersed and uncoordinated High Water Council, the new NWSA consolidated water resource management and planning into a single agency for all of Yemen.

Soon thereafter, the World Bank initiated another major project in the water sector. The city of Ta'iz was experiencing extreme water shortages in 1996. Piped water was only available every forty days. When the city water runs out in Yemen, people line up outside of mosques to fetch water to carry home for basic cooking and cleaning needs. Time spent fetching water is time taken away from doing other more productive things, such as attending school. The World Bank's Ta'iz Water Supply Pilot Project was a plan to drill wells in the surrounding rural farms, and then pipe the water into the city of Ta'iz. The farmers were compensated for their loss of groundwater. [63] The projected ended in 2001 and was considered unsuccessful because it was not a sustainable solution to the water shortage.

Between the creation of the NWSA in 1995 and 1997, the German Development Corporation, *Deutsche Gesellschaft für Technische Zusammenarbeit* (hereinafter, "GTZ"), provided consultant services to the Ministry of Electricity and Water regarding continued reforms of the new NWSA structure. [64] By November, 1997, the government of Yemen passed the Cabinet Resolution 237, which outlined the new structure for the NWSA and divided Yemen into forteen water management districts. [65]

In August 1997, the World Bank had released a report entitled, "Yemen – Towards a Water Strategy: An Agenda for Action," which recommended the following action points for addressing the impending water crisis:

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[63] *Project Performance Assessment Report: Yemen.* World Bank, Feb. 2006, Report No. 35004.

[64] *Ibid.*

[65] Sahooly, Anwer. "Public-Private Partnership in the Water Supply and Sanitation Sector: The Experience of the Republic of Yemen." *International Journal of Water Resources Development* (Routledge, June 2003).

- Reforming macroeconomic policies in order to create the right signals for water conservation and efficiency;
- Generating consensus among political leaders;
- Harnessing private sector energies in urban water supply; and
- Approaching partnerships to engage rural water users in self-management of their own resources.[66]

The action steps proposed by the World Bank's report outline the framework for and establish the foundation of a PPP for urban water distribution. The report also recognized the need to address key components of successful PPPs including institutional capacity, political support, and viable incentives for private and public partners.

In 1999, the World Bank launched another project, the Sana'a Water Supply and Sanitation Project, whose aim was to implement the new substructure of the NWSA in Sana'a first, as outlined in the Cabinet Resolution 237, and set the pattern for other towns in Yemen to follow. The project was successful in achieving its goals of institutional reform; however, it made no attempt to address the more crucial problem of water resource depletion. [67]

The Cabinet Resolution established the following three-phased plan, to be implemented over ten years:

- *Phase I.* Restructuring the National Water and Sanitation Authority in order to decentralize the branches and allow them to set tariffs to fully cover costs, control income and expenditures, and recruit their own staff (with the exception of top management positions).
- *Phase II*. Transformation of some of the larger NWSA branches into local corporations operating according to

[66] Dervis, Kemal et. al. *Yemen - Toward a Water Strategy: An Agenda for Action* (World Bank, Aug. 1997), p. ii.

[67] *Project Performance Assessment Report: Yemen.* World Bank, Feb. 2006, Report No. 35004.

market principles through local, as opposed to central, management.

- *Phase III*. Incorporation of a PPP into the operation of each local corporation after identifying the most appropriate contractual arrangement through a dedicated study.[68]

The World Bank's Sana'a Water Supply and Sanitation Project implemented the three phases outlined by the Cabinet Resolution over four years, between 1999 and 2003. The Sana'a office of the NWSA was one of the first branches to become autonomous as a newly formed local corporation, known as the "Sana'a Water Supply and Sanitation Local Corporation" (hereinafter, "Sana'a Local Corporation"). With the legal transactions accompanying this development completed in 2001, the first task of the newly created Sana'a Local Corporation was to embark on capacity building measures in order to develop a skilled, dedicated workforce to oversee a future partnership, which was recommended by the World Bank in 1997 as a factor in the success of PPPs. This entailed the establishment of a financial department with computers and software to manage accounting; the development of technical training and detailed job descriptions for employees; the restructuring of compensation to include performance-based incentives; and the launching of tariff studies accompanied by plans to increase tariffs to cover operations and maintenance, thereby developing a dedicated revenue stream.[69]

By mid-2001, the Water and Sanitation Corporation was ready to begin the process of incorporating a PPP into its operations. The process was carried out with procedural oversight and substantive consultation from representatives of the International Development Association, particularly during the

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[68] Sahooly, Anwer. "Public-Private Partnership in the Water Supply and Sanitation Sector: The Experience of the Republic of Yemen." *International Journal of Water Resources Development* (Routledge, June 2003).
[69] *Ibid.*

selection of the private sector partner and the development of the contract. The bidding schedule was set as follows:

- December 2001: the pre-qualification applications for prospective private contractors were released to applicants;
- January 2001: the applications were due.
- August 2002: requests for proposals were distributed to the pre-qualified applicants.
- March, 2003: the contract with the winning bidder would be awarded.[70]

Although the Sana'a Local Corporation followed the proposed schedule through January, 2003, it never entered into a formal PPP contract with a private firm for its operations.

After the success in incorporating an autonomous water supply and sanitation office in Sana'a, as well as professionally training the staff for operating the office, the World Bank determined that the Cabinet Resolution should be followed by other large cities in Yemen. The Urban Water Supply and Sanitation Project was launched in 2002, and its goal was to create local corporation for water supply and sanitation management in urban centers, including Ta'iz.[71] Another goal of the project was to include local participation in the establishment of the local water corporations.[72] This was mostly done through workshops in partnership with universities, donors, and the NWSA.

Along with the establishment of local water corporations, the Yemeni Parliament passed a new Water Law in 2002.[73] This law documented water rights for the first time, some following traditional negotiated water rights between villages and some

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[70] *Ibid.*

[71] *Yemen - Project Appraisal Document for the First Phase of the Urban Water Supply & Sanitation Program.* World Bank, July, 2002, Report No. 24478-YEM.

[72] *Yemen: World Bank To Upgrade Water Supply, Sanitation Services.* World Bank, August 1, 2002, Press Release No. 2002/040/MENA.

[73] *A Partnership Approach to Sustainable Groundwater Management in Yemen.* Ministry of Water and Environment, Yemen. Fourth World Water Forum, Mexico, March, 2006.