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A Reexamination of the Political Economy of Growth in MENA Countries[1]

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Abstract

Over the past two decades, economic growth in Middle East and North African (MENA) countries has been low and volatile. It has been argued that the problem is bad economic policies , such as excessive government interventions, large public sectors, restrictive trade policies, inefficient mass subsidies, and badly managed fiscal policies. But, these observations raise the question why these governments have followed such bad policies. This paper offers an analytical framework that can take the political economy studies of MENA countries beyond the simple claims that powerful interest groups have been blocking reform. It offers ideas about why interest groups and politicians cannot find ways to adopt better policies that generate larger surpluses for them to reap. The framework posits that the extent of contracting problems among interest groups and policymakers in a country depends on the characteristics of the country's resources, politics, and institutions. Resources (natural as well as human and physical capital) matter because they determine the possibilities for growth. Politics shapes the nature of conflicts in interests and the difficulties in contracting and in creating incentives for the efficient use of resources. Institutions are the rules that assign roles to individuals in the society and structure their interactions. The allocation of decision-making powers and the constraints that institutions place on individual behavior can help or hinder the potential for resolving conflicts and reaching efficient and enforceable deals. The paper examines a number of policies in MENA countries to show how the framework can shed light on the forces that may cause inefficiency in the interactions among the politicians, interest groups, and the public.

Introduction

Over the past two decades, economic growth in Middle East and North African

(MENA) countries has been low and volatile (see Figures 1 and 2). This has been the case compared to most other regions of the world as well as MENA's own experience in the 1960s and 1970s (see Table 1). Many scholars who have examined the issue have argued that the problem is bad economic policies adopted by many countries of the region. Indeed, most MENA economies can be characterized by extensive government interventions, large public sectors, restrictive trade policies, inefficient mass subsidies (especially through energy and food prices), and badly managed fiscal policies (Henry and Springborg, 2001). But, these observations raise the question why these governments have followed such bad policies. A number of political economy studies of MENA countries have sought to answer this question by examining the roles and characteristics of interest groups and politicians that may be inimical to the adoption of growth enhancing policies. However, the answers proposed by these studies are often incomplete because they do not clarify why in slow growing countries, interest groups and politicians cannot find ways to adopt better policies that generate larger surpluses for them to reap.

This paper offers an analytical framework that can take the political economy studies further and lead to more complete answers for the puzzle of slow growth in the MENA region.[1] The paper examines a number of policies in MENA countries to show how the framework can shed light on the forces

that may cause inefficiency in the interactions among the politicians, interest groups, and the public. Section 2 below discusses the analytical framework and section 3 applies it to MENA countries. Section 4 concludes.

A Framework for Analyzing the Political Economy of Growth

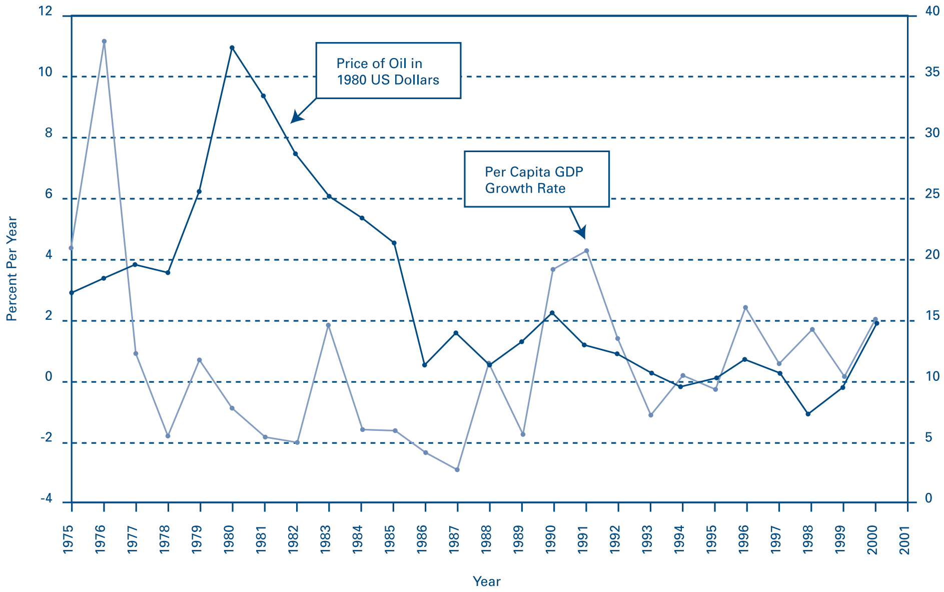
The political economy literature studies the role of collective action processes (i.e.,

1 This paper abbreviates and extends the framework and the arguments put forth in Esfahani (2000b).

interest group activity, policymaking institutions, and the like) in resource allocation and rent distribution. The part of that literature that is concerned with economic growth examines the impact of such processes on the incentives of economic agents to invest and to improve productivity. That is, the key political economy question from a growth perspective is how much of an economy's potential surplus (i.e., rents and quasi-rents or the value produced in excess of the recurrent costs of production) is realized and guided toward growth-enhancing activities. While political economy in general is also concerned with the distribution of the surplus, from a growth standpoint, distribution matters only to the extent that it affects the surplus that is channeled to productivity-enhancing investment.

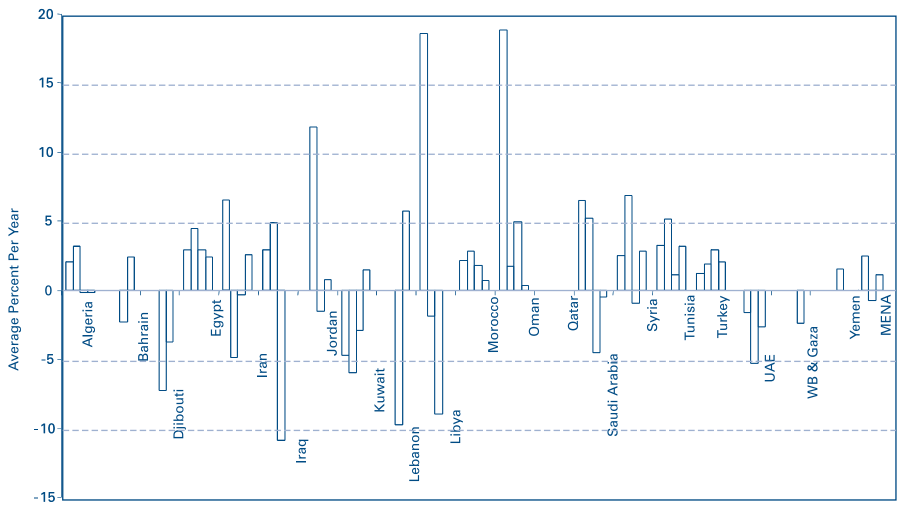
The main premise of the approach proposed here is that contracting problems are key impediments to economic growth in developing countries. In the absence of contracting problems, the members of a society should be able to motivate each other and remove all inefficiencies in investment and production. This should render the largest social surplus that is technologically possible and provide opportunities for rapid growth when the country is not already at the production possibility frontier. Thus, when growth remains low in a developing country, there must be contracting problems that prevent the realization or proper allocation of the maximum surplus. The more serious the contracting problems are, the lower the growth rate is likely to be.

Figure 1
Average Growth of Per Capita GDP in the Middle East and North Africa



Source: World Bank, *World Development Indicators 2002.*

Figure 2
Average Per Capita GDP Growth in MENA Countries Over Four Decades



Source: World Bank, *World Development Indicators 2002.*

Table 1
Differential Growth Experience of World Regions
(Real Per Capita GDP Growth Rates)

Growth	**60s**	**70s**	**80s**	**90s**
East Asia and Pacific	2.42	5.02	5.71	5.88
South Asia		0.33	3.55	3.40
Latin America and Caribbean	2.51	3.35	-0.11	1.45
Middle East and North Africa		3.40	-1.19	1.25
Sub-Saharan Africa	2.26	1.09	-0.70	-0.75
High income OECD	4.48	2.80	2.17	1.50
World	3.51	2.06	1.20	0.89

Source: World Bank, *World Development Indicators 2002.*

The extent of contracting problems in a country depends on the characteristics of the country's resources, politics, and institutions. Resources, both natural and human, matter because they determine the possibilities for production and the types of incentives required to reach efficiency. Human resources are particularly important because they can facilitate the identification of growth problems and the design and implementation of effective solutions for them. Politics shapes the nature of group conflicts that need to be resolved through government decisions. A more contentious set of interest groups create more demands for government controls over each other and raise the obstacles for the adoption of collectively beneficial policies by the government. In particular, such demands can lead to lack of appropriate regulations (or excess of inappropriate regulations) in the economy and, thus, result in significant inefficiency and slow growth. Finally, institutions are the rules that assign roles to individuals in the society and structure their interactions. The allocation of decision-making powers and the constraints that institutions place on individual behavior can help or hinder the potential for resolving conflicts and reaching efficient and enforceable deals.

Institutions have many aspects and dimensions. To make the analysis manageable, we focus on governance institutions because they play fundamental roles in alleviating or exacerbating deficiencies in other rules. Furthermore, we concentrate on institutional aspects that affect representation, coordination, and commitment in the interactions of various groups through the government. These three dimensions of governance institutions are crucial for helping the government adopt policies that keep the economy close to its production possibility frontier. The following discussion expounds this point.

For efficient collective decisions in a diversified society, various segments of the

population must be represented in the government, otherwise important information about the needs and valuations of some groups may not be incorporated in government decisions. Representation can be viewed as the set of political institutions that enable various groups to conclude effective contracts with the politicians, offering support or acquiescence to political power in exchange for policies that address those groups' needs. Effectiveness of such institutions depends on the capability of all parts of the population to ensure that their demands are given due consideration and weight by the policymakers.

Commitment consists of any cost that policymakers must bear if they decide to reverse an adopted policy in ways that take away the returns to investments made in response to that policy (Levy and Spiller, 1996; Esfahani, 2000a). The presence of such costs is crucial for economic growth because otherwise, important investments might be deterred. The reason is that most investments become largely sunk once they are in place, so their quasi-rents can be easily taxed without much economic consequence in the short run. If the politicians can change policies with no cost (or some net benefit) to themselves, they may find it convenient to ignore the losses of the producers. However, this possibility discourages entrepreneurs from investment in the first place. To ensure commitment, a country needs systematic checks and balances and separation of powers so that the decision-makers can turn their policies into enforceable contracts (North and Weingast, 1989). However, a dictator with a secure, long-term position may also be able to offer some commitment to efficient policies based on his incentive to maintain a reputation for future dealings.

Coordination is another crucial institutional feature needed for minimizing resource waste because distributive struggles typically create a "tragedy of the commons" problem where the parties involved tend to overexploit the source of rents over which they compete or overuse their own resource to secure a larger share (Persson and Svensson, 1989; Alesina and Tabellini, 1990). For example, when government budgets are made in parliaments where the lawmakers can independently and freely propose amendments, total expenditure and the deficit tend to be inefficiently large (Von Hagen, 1992; Alesina and Perotti, 1995; Velasco, 1999). The reason is that in such a situation, the cost of an additional dollar spent on the favorite project of each policymaker is shared by the population at large and, as a result, is not fully internalized. Similar problems exist in trade policy formation and many other public policies. Coordination across policy areas (e.g., coordinating trade, labor, and fiscal policies) tends to pose even harder problems and could be the source of major inefficiency in the economy if the country lacks appropriate institutional mechanisms. Of course, coordination would not arise as a problem to the extent that decision-making on public policy can be decentralized without external effects—e.g., in a market-like fashion. However, this is not possible in many areas of public policy, in which case there is need for other institutional mechanisms to bring about coordination. One mechanism is ex ante constraints (e.g., balanced-budget laws) that force everyone to act within limits, though such constraints are typically too inflexible and inefficient because it is difficult to specify ex ante rules that anticipate all possible future situations. A more flexible mechanism is "delegation," where one or a few individuals make the aggregate decisions that bring everyone into line. This obviously implies some centralization and, to be effective, requires proper incentives for those in charge of the aggregate decisions. An intermediate mechanism is ex ante limits that are renegotiated on a regular basis and only delegate the task of enforcing the agreed upon limits. Of course, the effectiveness of all these arrangements varies depends on the nature of other political institutions, such as political parties. For example, coordination is much easier when a few parties are in a position to aggregate the population's interests in a decentralized way and negotiate them with each other.

In making governance work effectively, capabilities in all three institutional dimensions discussed above—representation, coordination, and commitment—are needed. Indeed, there are complementarities among the three dimensions. In particular, higher commitment capability tends to be complementary with strength in both representation and coordination because it allows the government and interest groups to coordinate their actions over time, as well as across policy areas. In addition, it enhances the opportunities for the politicians to assure their constituencies that their interests will continue to be represented in the policymaking process. Conversely, better representation and coordination help ensure that the adopted policies enjoy broader support and greater efficiency and, therefore, are less likely to be reversed in arbitrary manners and without due process. Broader representation of the population in the policymaking process can also help coordination be achieved with more information and over a larger set of policy issues.

However, there are some tradeoffs among the three institutional dimensions as well, especially between representation and coordination. Better representation can make coordination more difficult because it requires the decision-making process to take account of more political demands. Conversely, coordination mechanisms may constrain the possibilities for broad representation. Of course, such tradeoffs and complementarities vary across countries depending on their economic and institutional conditions. For example, in a country facing chaos, establishing some mechanism for coordination is likely to be crucial and sacrificing it to ensure better representation may come at a huge cost in terms of economic growth. On the other hand, when the basic coordination problems have been solved, weak representation can become a key source of instability and inefficiency. Another example is the increased value of commitment capability when the government does not have access to cheap resource rents and cannot create employment and promote growth through subsidized private investment or public investment (Esfahani and Toossi-Ardakani, 2002). Some countries (e.g., those with less political polarization and better rule of law tradition) are able to resolve the tension among the institutional functions relatively well and reach high levels of capability in all dimensions. In other countries, long-term growth performance is constrained by the fact that some institutional capabilities are missing and trying to build them comes at a high cost in terms of other capabilities (e.g., try to reach representation undermines coordination).

The framework outlined above suggests that to understand the determinants of growth, one has to identify the political, institutional, and economic characteristics that are most relevant for growth-related contracting in a country. Then, the task is to analyze such characteristics and to show how their evolution has given rise to the country's pattern of economic growth. Below we provide an overview for the application this framework to MENA countries.

MENA's Growth Experience: Resources, Politics, and Institutions Policies

This section applies the above framework to examine the growth consequences of a number of characteristics that are more or less common across MENA countries. We start with a discussion of the role of natural resource rents and then examine the geopolitical factors, domestic political divisions, and governance institutions.

Natural Resource Rents

One of the most notable features common to many MENA countries is natural resource endowments, specially oil and natural gas. Even countries that lack such resources themselves benefit from the region's resources indirectly through aid from

richer countries or remittances from their migrant workers. Since the resources are invariably publicly owned, the abundance of the associated rents has reduced the need for taxation. As a result, compared to most other developing countries, political conflicts in the MENA region have more often focused the allocation of the public rents rather than on rent extraction from producers. Although statutory tax rates are in some cases rather high, especially on high-income brackets, in general the actual direct and indirect taxes paid remain relatively low.

Another consequence of reliance on resource rents has been vulnerability to the large fluctuations in the terms of trade. Although saving part of the rents during high resource-price periods and creating a stabilization fund could have solved this problem, few countries other than Kuwait have reached sufficient coordination in their fiscal policies to restrain their expenditures at boom times. In fact, many countries have done exactly the opposite, borrowing during booms when their creditworthiness has risen and paying back during busts when foreign lending has dried up. In addition, to maintain minimum amounts of expenditure during economic decline, governments have had to resort to inflationary financing. The consequence has been unnecessary macroeconomic instability. The causes of coordination failures that have played an important role in this instability will be discussed below.

In the absence of well developed credit and insurance markets, the considerable terms of trade fluctuations, their consequent instability, and the availability of public resources during booms have supported the rise and the maintenance of large public enterprises (PEs) in MENA countries. The same factors, especially the poorly-handled terms of trade shocks, have also strengthened the protectionist incentives as a means of supplementing the insurance offered through PEs and other means. Public support for economically highly costly labor laws and mass subsidization schemes in the region can be at least partially explained in the same way. The labor laws restrict layoffs and provide job and income security for the employed workers, but prohibit expansion of production and formation of new firms. The subsidies are intended to ensure minimum availability of staples for the poor, although in a number of important cases, subsidization is not targeted and the policy imposes huge costs on the economy as a whole. Some indicators of the restrictive and distortionary character of economic policies in MENA are provided in Table 2.

Besides their impact on policy outcomes, natural resource rents have influenced the evolution of political institutions in MENA countries. Because the ruling elites did not have to rely much on taxation, they have found it easier to continue their rule without much representation. The rents have allowed politicians to buy support in the polity, rather than being responsible to the public. In this way, the rents may have contributed to the survival of dictatorship in the region.

Geopolitical Rents and Threats

Military expenditure as a percentage of GDP in the MENA region is by far the highest in the world (close to 10% compared to the world average of less than 3%). Commensurately, the region has had its share of wars. The destruction caused by the wars, the funds spent on weapons, and the labor engaged in military service take considerable resources away from civilian production and investment. To a large extent, the demand for such military expenditures originates in the international conflicts in the region. But, it has also been supported by superpower rivalries, which have at times subsidized those expenditures and offered rents to strategic MENA

Table 2
Indicators of Liberalism of Economic Policy, 1995*
(All variables are indices between 1 and 5, with lower numbers indicating better performance)

Country	Trade Policy	Taxation	Government Consumption	Monetary Policy	Foreign Investment Policy	Banking	Wage & Price Controls	Property Rights	Regulation	Black Market	Overall Score
Algeria	5	3.5	3	3	3	3	3	3	3	3	3.25
Bahrain	2	1	4	1	2	2	2	1	1	1	1.70
Egypt	5	4.5	3	3	3	3	3	3	4	3	3.45
Iran	5	5	5	4	5	5	4	5	4	5	4.70
Iraq	5	5	5	5	5	5	5	5	4	5	4.90
Jordan	4	4	2	2	2	2	3	2	3	4	2.80
Kuwait	2	2	4	2	4	3	3	1	2	2	2.40
Morocco	4	4	2	1	2	3	3	2	3	3	2.70
Oman	3	3.5	5	1	3	4	3	2	2	2	2.85
Qatar											
Saudi Arabia	4	4	5	1	4	3	3	1	2	2	2.90
Sudan	5	5	3	5	4	4	4	4	3	4	4.10
Syria	5	5	3	5	4	5	4	4	2	5	4.20
Tunisia	5	3.5	2	2	2	2	2	3	2	3	2.65
Turkey	2	5	2	5	2	2	3	2	2	5	3.00
United Arab Emirates	2	1	3	1	4	3	3	1	2	1	2.10
Yemen	5	3.5	3	5	2	4	3	4	3	5	3.75

countries. Egypt and Turkey have been two most prominent beneficiaries of such rents.

International conflicts have provided the military establishments in MENA with an opportunity to grow and to gain control over resources not only by way of weapons and personnel, but also in the form of economic activities. In many MENA countries, the military owns and runs business conglomerates that produce military as well as civilian products (Richards and Waterbury, 1990: 360-367). Because of their superior political position and subsidized inputs (including draftees who come at very low cost), these

Table 2 (continued)
* Variable are defined and measured according to the following criteria:

Score	Trade Policy		Taxation				Government Consumption	Monetary Policy
			Income Tax Rate		Corporate Tax			
	Average Tariff Rate	Non-Tariff Barriers	Average Rate	Marginal Rate	Average Rate	Marginal Rate	As Percent of GDP	Inflation Rate
1	< 4%	Very Low	<10%	<10%	Close to 0	Close to 0	<10	<6%
2	5—9%	Low	10—20%	<25%	<25%	<25%	11—25	7—13%
3	10—14%	Moderate	15—20%	<35%	<25%	26—35%	26—35	14—20%
4	15—19%	High	15—20%	36—50%	>25%	36—45%	36—45	21—30%
5	>20%	Very High	>20%	>50%	>25%	>46%	>46	>30%

Score	Foreign Investment Policy		Banking		Wage & Price Controls		Property Rights	
	Legal Restrictions	Government Attitude	Entry Barriers	Government Controls	Prices	Wages	Legal Guarantees	Juridical Enforcement
1	Very Few	Encouraging	Very Few	Light	None	None	Complete	Efficient
2	Some Sectors	Neutral	Few	Some	Some	May Have Min.	Complete	Lax
3	Many Sectors	Neutral	Many	Tight	Many	Many	Incomplete	Efficient or Lax
4	Case-by-Case	Discouraging	High	Very Tight	Common	Common	Very Limited	Absent
5	Case-by-Case	Actively Discouraging	Very High	Chaotic	Complete	Complete	Nonexistent	Irrelevant

	Regulation			Black Market
Score	Rules	Restrictiveness	Enforcement	Share of GDP
1	Straightforward	Very Low	Efficient and Uniform	< 10%
2	Simple	Low	Mostly Efficient and Uniform	11—15%
3	Complicated	Substantial	Haphazard	16—20%
4	Complicated	High	Haphazard and Partly Corrupt	21—30%
5	Ubiquitous	Extreme	Very Haphazard and Corrupt	> 30%

Source: Johnson, Bryan T., and Thomas Sheehy. 1996. *1996 Index of Economic Freedom*, Washington, DC: The Heritage Foundation.

conglomerates compete well in domestic markets and government contract auctions. As a result, they have turned into an economic force that has influenced the path of

trade and industrial policies.

The role of geopolitical rents goes beyond subsidization of the military and includes support for the ruling politicians in MENA countries. Along with the natural resource rents, this is another factor that may have helped the longevity of dictatorships in the region. A number of scholars have also suggested that external rents may have weakened the urge to implement market-oriented reforms in the region (Richards, 1991; Löfgren, 1993). This issue, which has been more broadly debated in the context of the role of foreign aid, is far from settled. Countries with easier access to foreign resources can be in a better position to pursue objectives such as employment and stability without distorting domestic production and foreign trade. The reason why they maintain the distortions may lie in other institutional weaknesses, such as failures in representation, coordination, and commitment. In any event, the issue is important and should be carefully examined by the case studies.

Homogeneity and Heterogeneity

Compared to other regions in the world, MENA countries generally enjoy a much higher degree of ethno-linguistic homogeneity. Based on the results of cross-country studies, this factor must have contributed to better representation and coordination in policy-making. However, ethnic divisions in some countries have been the source of major conflicts. In particular, the Kurdish minorities in Iran, Iraq, and Turkey have all been engaged in armed conflict with their governments. Lebanon has been the scene of one of most destructive civil wars. Other examples are the war in Western Sahara and the less intense conflicts between Berbers and Arabs in North Africa. Along with international conflicts, these tensions have strengthened the role of military establishments in several MENA countries and have provided justification for repressive government policies.

While there is some aggregate evidence that ethnic conflicts adversely affect policy outcomes, the details of how ethnic divisions influence policy making have hardly been studied. As Bates (1999) argues, ethnic divisions need not lead to conflict and may in fact positively affect economic performance under some conditions. Certainly, ethnic divisions tend to increase internal cohesion within each ethnic group, which may help solve a great deal collective action problems that arise in more amorphous societies. These issues are worth pursuing in case studies to shed light on positive and negative effects of ethnicity on economic policy and to search for ways in which the negative effects can be mitigated.

Autocracy

Weakness of democratic institutions in most MENA countries is inevitably a part of any explanation of their past policy outcomes. Most conspicuously, extreme centralization of decision-making and lack of representation have led to very poor quality and arbitrariness of many policies. Changing policies without due process has been a major complaint of domestic and foreign businesses in MENA countries.[2] On measures such as ICRG's risk of contract repudiation and rule of law (see Table 3), MENA countries used to rank among the lowest in the world. Although things have improved in recent years, compared to other parts of the world policy-induced business risks remain high in MENA countries. Another manifestation of lack of democracy has been the poor quality of services with public good components, such as education and healthcare, which remain undersupplied in the region.

Although natural resource rents and internal and external conflicts have contributed to the survival of autocracy in MENA, the institution has deeper roots and other socio-cultural causes as well. These roots have long been debated in the political economy literature, going at least as far back as Marx's idea of an "Asiatic Mode of Production." Whether the root causes will continue to exert their influence in the coming decades or not is also an important question. However, it appears that the changing composition

of endowments in the region is counteracting with the old causes and bringing about institutional change. In recent years, the region has seen major strides toward democracy in some countries that have been attributed to the rise of human capital and the decline of natural resource rents as a source of income (e.g., the recent democratization movement in Iran). The more educated labor forces of MENA countries demand greater participation and, when the government ignores them, their increased mobility imposes larger costs on local economies and ultimately on the governments.

While democratization is desirable for a variety of reasons, from an economic policy perspective it also poses major policy challenges that are rather unfamiliar to polities in MENA. While democracy increases representation, it makes coordination more challenging. For example, there is a great deal of historical and cross-country evidence that the expansion of franchise increases demands on public expenditures. Also, compared to stable autocracies, democracy tends to increase the turnover in the leadership. This shortens the horizons of policymakers in office and can weaken their incentives to coordinate or even represent the polity's interests. In MENA countries with limited capability in tax administration, these demands may lead to unsustainable budget deficits unless, of course, appropriate institutions are put in place to help competing interest groups coordinate their actions in the macroeconomic policy

2 See Esfahani (Forthcoming) for a host of examples. For instance, in Egypt, following the rise in foreign investments in 1981, the Minister of Energy decided to raise the price of energy and petroleum products for FDI projects by a factor of 3, bringing it to the world market level. He argued that the substantially subsidized domestic price was for users who did not enjoy the privileges of the foreign investment code (Middle East News Agency, Economic Weekly, 1989, May 19: 13). Given that the privileges were supposed to be incentives for foreign investors and those who had invested in Egypt had assumed a uniform price of energy, the policy change placed FDI projects at a disadvantage vis-à-vis their Egyptian competitors. Some investors were so disappointed that they closed their operations (Sadowski, 1991, p. 115). Another, more specific case is the cancellation of a US firm's contract for the management of duty-free shops at the Cairo airport. The contract was subsequently awarded to Egypt's major public sector airline, EgyptAir, which has been benefiting from the support of airline industry regulators in many other respects, e.g., the limitation of charter flights to Cairo (BME, 1995, November 16-30: 10).

Table 3
ICRG Measures of Institutional Performance, 1995*

Country	Contract Repudiation	Expropriation Risk	Corruption	Rule of Law	Bureaucratic Quality
[Range]	[0-10]	[0-10]	[0-6]	[0-6]	[0-6]
Algeria	7	10	3	3	2
Bahrain	9	10	4	5	4
Egypt	9	10	4	4	3
Iran	7	8	4	5	4
Iraq	1	1	1	2	2
Jordan	8	9	4	5	4
Kuwait	9	10	3	5	3
Morocco	8	9	3	6	3
Oman	9	9	3	5	4
Qatar	9	9	2	6	3
Saudi Arabia	8	9	2	6	3
Sudan	4	5	2	2	2
Syria	8	9	4	4	3
Tunisia	8	9	3	4	3
Turkey	8	9	4	4	4
United Arab Emirates	8	9	2	4	3
Yemen	7	9	3	3	3

* Variable definitions:

(1) *Contract Repudiation* indicates risk of a modification in a contract taking the form of a repudiation, postponement, or scaling down due to budget cutbacks, indigenization pressure, a change in government, or a change in government economic and social policies. Lower scores indicate higher risks.

(2) *Expropriation Risk* indicates the assessed risk of outright confiscation or forced nationalization. Lower scores indicate higher risks.

(3) *Corruption* is an indicator of the degree of "improper practices" in the government. The higher the indicator, the lower the degree of corruption.

(4) *Rule of Law* reflects the degree to which the citizens of a country are willing to accept the established institutions to make and implement laws and adjudicate disputes. Higher scores indicate sound political institutions, a strong court system, and provisions for an orderly succession of power. Lower scores indicate a tradition of depending on physical force or illegal means to settle claims. Upon changes in government in countries scoring low on this measure, new leaders may be less likely to accept the obligations of the previous regime.

(5) *Bureaucratic Quality* indicates autonomy from political pressure and strength and expertise to govern without drastic changes in policy or interruption in government services as well as the existence of an established mechanism for recruiting and training. Higher scores indicate higher quality.

Source: *Political Risk Services Inc. (1996)*. Variables are defined in Knack and Keefer (1995).

area. Similarly, without enhancing the coordination mechanisms, democratization may increase the demand for protection and slow down the trade liberalization process.

The impact of democratization on policy commitment is also complicated and depends on the details of the institutions that structure the government's decision-making process. On the one hand, the democratic process is going to make policy change more difficult because a larger number of interest groups become involved in the process and may have conflicting preferences. On the other hand, the shorter time horizon of policymakers may induce them to choose lower quality policies and refuse to honor promises made by their predecessors. Again, there are complementary institutions (e.g., an independent and competent judiciary, a strong party system, a capable and meritocratic bureaucracy, etc.), that can mitigate this problem. But, MENA nations are not very well endowed with such institutions and need to build them as the democratization proceeds.

Along with democratization, a process of decentralization has started in some MENA countries. This is a natural process and is likely to contribute to the quality of public services at the local level. However, like democratization itself, its success is contingent on a set of complementary institutions that ensure coordination at the macro level. The unfortunate experiences of Brazil and Argentina with decentralization in the 1980s and their contrast with the operation of federal systems in the United States and Germany, among others, contain important lessons for the arrangements that must accompany decentralization to ensure success.

Weak Judicial and Administrative Institutions

Administrative and judicial institutions are notoriously ineffective in MENA region. Court cases take a long time to settle and there is considerable public concern that judgment may not be competent and impartial. The bureaucrats are also suspected of

incompetence and impartiality. Indeed, MENA countries typically score quite low in rule of law and corruption surveys (see Table 3).

The negative effects of judicial and administrative weaknesses are well known and have been discussed above. An important question is why MENA governments have been slow to reform those institutions. There is a literature that addresses questions of civil service and judicial reform. But, that literature is mostly concerned about what the new arrangements should look like and what benefits follow from them rather than under what conditions a government finds it worthwhile to implement such reforms. Since governments have not been acting much on these fronts, preaching the virtues of alternative institutions is clearly insufficient. The underlying problems of reform need to be identified and addressed. If changes in other institutions or resource endowments can help facilitate reform, it may be worthwhile at present to pay attention to those factors rather than the reforms themselves. The fact of the matter is that these issues have been difficult to address and we do not know much about them. The GRP project offers an opportunity to think about the costs and benefits of various reforms and to determine whether research along the lines being pursued for PE and trade reforms can produce shed light on the feasibility of civil service and judicial reforms.

Conclusion

This paper offers a broad framework for the analysis of political economy factors in economic growth. The interaction of economic performance and political economy factors is quite complex and it may be difficult to take all effects that matter into account. However, the hope is that by considering a wide range of issues and thinking about them systematically across many countries, we would be able to come up with a better sense of what matters and what doesn't. As a preliminary attempt in that direction, this paper examines a number of key characteristics of MENA countries and relates them to growth-hampering economic policies in those countries.

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