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IDEAS, NETWORKS AND JOBS: REBASING GROWTH
IN THE MIDDLE EAST AND NORTH AFRICA

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Abstract

Oil rents are set to wane. In the MENA Region, the legacy of four decades of dependence on oil is an economy that is not generating enough opportunities for productive employment. This paper set out a policy agenda for gradual change that is cumulatively transformative. Directly, productivity can be increased by encouraging clusters of firms capable of innovation, linked to vocational training that equips a workforce with the skills that firms need. But the socio-political transformation from a rent-seeking economy to a skill-based economy is more complex, requiring both cultural and institutional change. This cannot be planned in detail: a transformation is a unique event subject to radical uncertainty. It calls for a process of rapid social learning based on experimentation. As the society adapts, new opportunities open, and the next steps clarify. I give examples of how an adaptable framework has been built elsewhere.

Keywords: Oil rents; job growth; social learning; Middle East

JEL Classifications: O20, O25, O53

1. Introduction

The challenge facing the MENA region is all too obvious. As oil rents are set to wane, the legacy of four decades of dependence is an economic structure that is not generating mass opportunities for employment that are sufficiently productive to sustain the living standards that the population has come to expect. What is not obvious is what can be done about it. This paper attempts to chart a course for public policy. The bare bones of building productivity at 21st Century levels are not mysterious: clusters of firms capable of innovation have to be built, and linked to vocational training that equips a workforce with the skills that firms need. In Section 2 I discuss how such clusters can be built. But the scale of the change from a rent-seeking economy to a skill-based economy is massive. It requires both cultural and institutional change, and the changes are too large to be planned in any detail: it is a transformation. The transformation of a society is a unique event and so, by its nature, it cannot be planned in detail; any set of proposals will need to be responsive to unanticipated future events and resilient to shocks. Unique events are by their nature subject to *radical uncertainty*. The way to navigate such uncertainty is to build a process of rapid social learning based on experimentation, not by insisting upon implementing a highly-specified plan. As the society adapts and experiments, new opportunities will open, and next steps will become clearer. Creating an adaptable framework is therefore essential. There are successful precedents and I discuss the approach in Section 3.

2. Local Networks and Local Jobs

For people to become productive workers, a series of conditions have to be met.

The most elementary is that the potential for economies of scale and economies of specialization has to be realized. For that to happen workers have to be organized into teams. This is the most fundamental function of the firm. In sub-Saharan Africa this has yet to happen – most of the workforce works solo or in microenterprises, dooming people to low productivity. Even in MENA there are too few firms: too much of the labour force is either in small informal enterprises or in the public sector.

One level up from the firm is the cluster. Firms cluster together partly to reap further scale economies which accrue at the sector level rather than within the firm: this is why the city of Qiaotou has so many button-producing firms that makes two-thirds of the world's supply. But firms also cluster together to reap the gains of specialisation: the firms in the cluster are interdependent. For example, London has a vast range of firms specializing in distinct aspects of finance and law, enabling complex transactions that require a wide array of distinct skills to be completed swiftly. A successful cluster depends upon a city with good connectivity both internally and externally. Developing such cities, in which the large population needed for scale and specialisation does not result in congested gridlock, requires huge and timely public investment.

The third level of productivity is to organize the training of a local workforce that is equipped with the skills needed by the firms in the city. The labour market does not do this automatically because neither individual firms nor individual workers have sufficient incentives to invest in

training. If a firm invests in a general skill, the rational action is for the newly-productive worker to quit for a rival firm that can afford to pay him more since it does not need to recover the costs of training. If a worker invests in a firm-specific training, the rational action is for the firm to exploit his new productivity. In principle, these can be addressed by workers investing in general skills and firms investing in firm-specific skills, but in practice efficient training will often intertwine general and firm-specific skills. Further, workers face much higher costs of borrowing than firms, and so will under-invest even in general skills. Hence, public policy is needed to generate the required level of investment in skills. However, state-provided training is unlikely to be successful because it is too detached from the changing needs of employers. To ensure that training is pertinent, firms must be intimately involved in the provision of training, usually in collaboration with local colleges so that an integrated balance of firm-based and classroom-based methods evolves. The challenge for public policy is partly to organize a levy on firms that forces them to finance skill acquisition, and partly to broker the marriage of college-based and firm-based facilities.

The fourth level is to reorganize the structure of authority so that it corresponds to the decisions that need to be taken at the level of the urban cluster. This has opposite implications for business and government. Businesses are organized to compete with each other. But for the provision of city-wide training they need to cooperate. Locally-based businesses need to come together, forming associations that can work as a counterpart to local government, both for appropriate training and as a lobby for appropriate urban infrastructure. Conversely, government needs to be decentralized from national to city-level authority so that training colleges can be organized that are pertinent for the changing array of firms located in the cluster.

The final level of productivity is not to equip the workforce with skills, but to equip firms with the skills needed to remain abreast of the international competition. This draws less on training colleges than on university research departments, although the flow of knowledge is not simply from universities to firms. The experimental innovations of firms provide a flow of new knowledge back to universities. However, as with training, this requires decentralization of government: universities need sufficient local autonomy to be able to collaborate with local government in financing the research pertinent for the type of firms that the city hopes to attract.

Hence, the nexus of high productivity is a combination of formally organised firms, local government, and local tertiary education that work together to create and maintain a cluster of high productivity. The firms are spatially clustered together by products and interdependence, and organizationally bound into collaboration by business associations and government training levies. The local government has sufficient financial and policy autonomy to invest in the infrastructure that enhances the productivity of the firms that it seeks to attract to the city. The tertiary education sector is organized to train the workforce that the firms need and to conduct the research that keeps firms competitive. The whole system is designed to respond flexibly to change: each part has an incentive to spot emerging problems and work within the system to prepare appropriate responses.

This is what has been achieved in some American cities such as Boston, some European cities such as Munich and Edinburgh, and some Asian cities such as Singapore. It is feasible for MENA countries: they already have major cities; they already have well-equipped universities; and they already have some capable large firms. But psychologically it requires a huge shift from the rent-seeking style of life that has been endemic. As carefully documented by Diwan and Maleek (2019), firms have relied upon crony capitalism to prosper rather than on productivity. Similarly, educated young workers have used their education to acquire credentials for entry to the public sector rather than to acquire skills that would make them productive in commercially sustainable activity. Meanwhile, government has been organized around command-and-control by highly centralized authority, rather than into decentralized structures of authority designed according to functional pertinence and trusted to fulfil purposes that they have fully internalized. I now turn to this psychological and institutional transformation.

3. Transformation under Radical Uncertainty

Shifting from a centralized rent-seeking society to a decentralized productive society is such a major transformation that it cannot be fully planned in advance. It is subject to radical uncertainty and as such depends upon igniting rapid social learning so that the society error-corrects as it attempts change. This is in essence the strategy that Deng adopted in transforming China. It was summarized in two images that he used: ‘feeling your way across a river, stone by stone’, and ‘It doesn’t matter whether a cat is black or white as long as it catches mice’. These accepted that the process involved radical uncertainty, and permitted experiment.

Embarking on a radically uncertain process inevitably arouses fears, but apprehension is compounded because MENA countries are starting from a situation very different from that which characterized East Asian countries at the onset of their successful transformations. East Asia started from low incomes and strong states, whereas MENA countries start from incomes that are quite high because of oil rents, and states that have become somewhat fragile. The East Asian economic transformation was a simple one of pulling people out of low-wage/low-productivity occupations (such as primitive agriculture) towards more productive higher-wage manufacturing. In MENA wages are too high to ignite such a process., many of the states in MENA are currently fragile. The East Asian transformation was implemented by states that were effective and purposive. MENA states are characterized by some of the classic features of fragility: a weak private sector, a low level of political legitimacy, and limited state capacities (International Growth Centre, 2018). The state is built on a top-down basis, rather than on a set of reciprocal obligations between rulers and citizens which implicitly form a social contract in which citizens pay broad-based taxes in return for public services.

Given the starting point, it is natural to be fearful of an uncertain transition. But the fears have to be faced because there is no viable alternative: the present structure is unsustainable. Oil revenues will rapidly wither, and the working-age population will rapidly increase. Continuing along a path which is unsustainable is far more dangerous than embarking on uncertain change since it can only end in crisis. Transformation, albeit uncertain, will succeed as long as strong mechanisms for rapid social learning and error-correction are put in place. The overarching

objective is for the growing inflow of young job-seekers to find productive employment in the knowledge clusters discussed above, instead of working in low-productivity bureaucracy, low-productivity crony capitalism, and low-productivity informality.

Underpinning the change from centralised bureaucracy and crony capitalism to decentralized government, purposive tertiary education, and market-disciplined firms are two profound transformations, one in institutions and the other in norms and cultural practices. The first of these has been discussed extensively in the contemporary literature, (for example, Acemoglu and Robinson, 2012), but the latter has received much less attention. However, the two are deeply complementary; many institutional innovations work only when the people who work in the institutions bring cultural practices which are well-suited to their operation. Changing these requires a change in mindset and ideas across the society.

Political leaders rarely have enough power to implement the huge task of transforming their society simply by issuing commands. If people are reluctant to comply they can usually find a myriad of ways to inhibit change. Hence, leaders need to gain a degree of willing compliance from their citizens and for this they need to go beyond issuing orders: they need to change minds. People's minds are filled the ideas they get from their social networks, such as families, from organizations, such as their places of work and prayer, and from media. The few people who are at the hub of these networks and organizations are vitally important as communicators. Political leaders are not just the Commanders-in-Chief, they are the Communicators-in-Chief: by communicating effectively and consistently, they can gradually reset the ideas that people hold. They have two means of communicating: what they say, and what they are seen to do. By far the most effective form of speech is *narrative*: most people find stories easy to understand and to remember. The use of visible actions to reinforce credibility is analysed rigorously in the Theory of Signalling.

Well-used, narratives and signalling actions fit together, complementing each other. By using appropriate narratives leaders can convey the meaning of an idea to people clearly and memorably. By matching this with visible behaviour that is consistent with the idea, the leader's message becomes more credible: he 'walks the talk'. While the narrative needs to be aspirational it is also important to stress the necessity of change by allusion to potential outcomes without transformation. One of the hardest steps is to convince a population to embrace change. Indeed, this is hard in any society, as the recent experience of France has shown.

A key principle of charting a path is not to overload the reform the agenda. When an economy has many distortions, it is tempting to deal with all of them (and reform strategies are spoilt for choice). But a long wish-list is unwise. A step-by-step process involves focusing on tangible short-term wins. By acknowledging uncertainty, the leader gradually builds a culture of experimentation, in which a range of options are tried and carefully monitored to see what works.

A national communication strategy that builds willing compliance with change, conveys three distinct ideas (Collier, 2018, 2018a). One is of shared identity: in effect, the proposition that we all belong together. The second is a causal proposition of the form ‘if we all take part in this endeavour, then we, or our children, will all be better off. The final idea is a normative proposition: it tells people to esteem those of their fellow-citizens who take part in the common endeavour, and to disapprove of those who fail to do so. Once these ideas are accepted, they reinforce each other. The shared identity describes the domain over which these reciprocal obligations apply; the causal proposition explains the purpose of the endeavour and thereby gives a rationale for the obligation. People comply willingly because they value the esteem of their neighbours, and fear disapproval.

While once these beliefs are widespread they are self-reinforcing, they can seldom be spread widely all at once. In practice it is useful for a leader to target a group of people who become the vanguard for changed behaviour. In MENA the obvious vanguard is youth. It is easier to change the culture of the youth than that of older people, and youth are the people who most need to change and who stand to benefit most from change. Indeed, youth naturally see themselves as a cultural vanguard. The communication strategy needs therefore to be tailored specifically for them. Young people need to see themselves as the generation that will create a new self-sufficient society. They can be given a sense of purpose: ‘only if youth acquire vocational skills can the country attain self-sufficiency’. This can be matched by an underlying normative proposition: ‘vocational training is an activity to be rewarded with esteem’.

In the process, there is a shift in the source of self-esteem from *being* to *doing*. Prestige becomes attached to *doing something that is productive for society*, not merely *being in a position*. Given that currently, esteem comes from being in the public sector, it might be sometimes be necessary, especially in the Gulf, to make this transformation in two stages. First, shift the source of esteem to *working productively in the public sector* and only later take the second step of shifting esteem to *working productively in the private sector*. Hence, the first step might involve creating more productive opportunities within state-owned enterprise. However, any state-owned enterprises need to be subject to genuine market tests; only then will they create sustainable change. Infant industry arguments along these lines would require careful management along a transition path towards self-sufficiency. It is unlikely that these enterprises can compete in world markets and consideration should therefore be given to entering sectors with less exposure to foreign competition.

Narratives are most effective when they are culturally specific and credible. The pace of change is not going to be rapid: no MENA country is going to become Singapore. Each country is unique and so it cannot adopt a narrative which amounts to becoming a replica of somewhere else. Such a narrative could be more dangerous than helpful. It amounts to looking at someone else’s finished building rather than erecting the scaffolding to build your own house. The learning from other countries should focus on the scaffolding – the process of how transformation was achieved. The scaffolding used by China had four components. The first was an overarching narrative spread around the population, namely to rebuild a prestigious, proud China. The second was a political leadership that encouraged intensive, rapid social

learning to understand what would work within the local context. The third was to evaluate the performance of those who held positions of authority and hold them to account for success and failure. The fourth was decentralization, used to foster yardstick competition across jurisdictions, further encouraging experimentation on a local scale.

Rapid social learning can only happen if policy makers and decision-makers acknowledge that there are many aspects of the reform program which they cannot yet understand: that they know they do not know. Success lies in a step by step approach and learning from the steps. In China, the political leaders enforced the need to experiment and changed the perception of failure so that it became seen as a positive learning experience. Local leaders were forced to experiment: if companies, institutions and bureaucracy did not innovate, they were judged to be failures. Bureaucracy changed as leaders encouraged experimentation. Hence, running a series of social experiments should be a core element of the actions to be taken in support of the narrative. The experiments should be done on a small scale –large experiments are too risky.

Institutional change is not sufficient but it is important. The development of institutions can create convincing signals making cultural change credible. Articulating new rules can also facilitate shared understanding of the steps that need to be taken and can create incentives to do so. Institutional reform can also provide a context for bringing in new people to the policy process with different mentalities, goals and ambitions.

Institutions and culture co-evolve. Just as institutional rules signal the formal norms, so culture embodies the informal norms. The culture of an institution becomes established where its staff become willing and competent in what the institution is tasked to do. This requires the appropriate level of staffing and analytical resources. There are many examples of institutional reforms in the real world which have been able to change norms and practices as well as creating new rules. A good example is having an *Independent Office for Budget Responsibility* as established in Britain in 2010. It has the potential to instil discipline, particularly around spending based on realistic long-term projections for the price of oil. This would avoid the current situation of public expenditure following oil prices in a pro-cyclic fashion. Improving the framework for budgetary forecasting can be used to change narratives around public management, forcing policy-makers to pay attention to longer term goals. And it is injecting an element of independent thinking and analysis into policy. But the details of institution design matter. It is important that the institutional goals are carefully specified, that the system of accountability is specified, and that there are sufficient human and financial resources for the body to do its job to a high level. Institutions can be set up to fail. Giving an institution the wrong mandate amounts to giving it a death sentence. For example, no institution to improve fiscal management should be judged on whether its forecasts are accurate as these are invariably wrong even when they are performed by the most competent analysts. Similarly, attempting to implant western style cultures and institutions into MENA will not work.

The importance of not overloading the narrative carries into implementation. Failure is most commonly due to trying to do too many things at once. The fear of failure and the reality of

failure are demoralizing. Visions are grand leaps. However, actions and initiatives in support of the narrative should not take the form of leaps. Rather they should be considered more akin to scaffolding. Scaffolding supports the construction of a building but when it is taken away on completion the building stands on its own. The scaffolding of actions and narratives for transformation are the gradual changes in institutions and ideas that pave the path along which the local knowledge clusters that enable a workforce to be productive get built.

China discovered the scaffolding that it needed for transformation from experiments within its regions. Since these experiments were conducted within an area bounded by a common culture and institutions, the lessons from one place were likely to be pertinent for others. MENA is even better-placed to undertake experiments within its own region of cultural and institutional similarities, because it consists of many sovereign states. In China, the central government had to convince regional leaders that they would not be punished for branching out from what had been nationally-imposed policies. MENA is fortunate that it does not have a MENA-wide central government: experiment is much easier. But in China, once experiments got underway, it was easy to spread. The learning from them because the institutions of the central state could evaluate them and disseminate ideas around other regions. MENA's strength in being able to experiment is its weakness in spreading the learning from them. What has been missing in MENA are the institutional structures designed to learn from experiments in other countries within the region. What MENA needs is not regional *power* structures, but regional *knowledge networks* capable of evaluating experiments and spreading the lessons from them. *All* new experience is valuable: societies can learn not only from successes, but from failures. ERF is just such a network. As the region's premier social science knowledge network, ERF's role in speeding the transformation of the region is exceptionally important. The first 25 years of the ERF have gradually built an organization that can be truly valuable in the decisive period of the next 25 years.

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