

**TOWARD A POLITICAL ECONOMY OF
TRANSITION**

Notes and Reflections by Adeel Malik

THE MOMENT WE ARE IN

Failure of the Arab development model

Manifestations of latent conflict

Politics of fiscal adjustment and the ensuing middle class grievance

Rise of crony capitalist structures

Persistence of a large shadow economy

Insider-outsider dynamics

The region needs a new social contract
(with a stronger role for the private sector)

Falling oil prices have offered a more revolutionary moment than the Arab uprisings of 2011

SEVEN DIMENSIONS

Time

Incentives

Rents

Uncertainty

Process

Coalitions

Nonlinearities

TIME

There is NO well-developed theory of institutional change

Two erroneous assumptions of neo-classical theory:

Institutions do not matter

Time does not matter

It takes a 'very long time' to create institutions that support development

It took England 200 years to make a transition from a minimally effective state to a developed polity (Hough and Grier, 2015)

Transition dynamics are often misunderstood

State failure can sometimes be a creative institutional moment

RULER INCENTIVES

What motivates rulers to give concessions?

When there is fire under their feet!

The 'revolution constraint' on elite preferences

'Systematic vulnerability' is important for shaping elite incentives

Resource-scarcity tends to be an important driver of institutional change

Incentives of those with the greatest capacity for violence

Change begins when those with coercive capacity side with productive forces

Change has to be conceptualized as a process compatible with elite incentives

RENTS

The functional role of rents in minimizing violence and fostering economic development
A substantial revision of the literature pioneered by Krueger and Bhagwati

Crony capitalism was the norm in most experiences of capitalist transformation

Examples: Britain in 17th Century and United States in 18th Century

Korea, Vietnam, Indonesia and many others

North (1991):

In early stages of development all economic organizations are also political organizations

Few countries where capitalists emerged independently from the state

The new discourse on 'Cronyism' in the wake of Arab uprisings

RENTS FOR DEVELOPMENT

Whether rents enhance the productive frontier?

Are they time-bound?

Primacy of *Linkages*

*Not just how capitalists are connected to the state and political functionaries,
but how they are connected with other productive constituencies*

Was the asset confiscation of politically connected firms a sensible policy?

The case for institutional conversion

Key Q: How to orient rents towards development?

*China's dual track reform: Preserved rents for economic agents tied with the old system
...while creating new rents through liberalization of the economy*

UNCERTAINTY

Sharp falls in investment and output but heightened expectations for immediate economic relief

A primary question in navigating the transition:

How to resolve aggregate uncertainty?

Uncertainty increases risk aversion towards reform

Reform appears more threatening than it actually is!

Crucial uncertainties for the ruler's objective function:

What is the true level of support for the regime?

How much redistribution is enough to generate compliance of masses?

How much to repress?

THE COMMITMENT PROBLEM

Rulers face an important commitment problem:

How to agree for reforms today that might undercut their power tomorrow?

Most successful transition experiences were built on:

*open door, gradualism, momentum with consensus
ruler's stability*

Can ruler's stability be traded with willingness to reform?

Regional growth bargains that guarantee ruler's stability in exchange for essential reforms?

PROCESS

Replicating outcomes without understanding the process

Examples: Premature democratization, private sector development, good governance

Context:

Initial conditions, different historical legacies, variations in political settlements

Sequencing

As Saudi Arabia and Oman prepare for foreign debt issuance, there might be greater reception for financial sector reform that are otherwise resisted

Competition policy

Dual-track process of reform

Keeping elements of the old system in place while making changes on the margins

COALITIONS

Politics is crucial to the reform process – but not in the restrictive sense of electoral democracy

Importance of negotiations, compromises and bargaining structures

Institutional linkages to social actors

A discourse on economic reforms

Coalition building is important for generating countervailing political momentum

...but it can also hold up reform by paralyzing decision making

Broadening the ‘selectorate’

Understanding what dominant coalitions are composed of

Expanding the coalitions through widening access

NONLINEARITIES

Complementarities in the development process

Favourable development outcomes often appear in a cluster

Map of social, economic and political connections that defy an easy causality

Rhizome: الجذمور (jadhīmūr) – the opposite of a tree like structure

Challenge: How to create a combination of positive forces?

The whole is greater than the sum of its parts!

THE REGIONAL DIMENSION

The role of regional complementarities

Regional market access acted as an important commitment device and ensured irreversibility of the reform process

Eastern Europe in the late 1980s

China after the Mao period

Turkey in 2000s

Vietnam's Doi Moi (1986-2016)

Financing of social contracts in resource-scarce MENA countries

The moral hazard problem associated with free cash flows from GCC

THE 'EXTERNAL' DIMENSION

The internal and external are co-constituted in Arab political economy

The post-intervention political order in the Arab world is defined by ethnic and sectarian political settlements

divisive – rather than cohesive – political elites
unlikely emergence of common-interest institutions
low incentives for investments in state capacity

The West's 'convening authority' => deployed more towards warfare rather than welfare

It is difficult to break the violence trap without imagining a new economic order that replaces the spoils of war economy with the rents from multiple exchange relationships

Absence of a coordinated development strategy or the vision for a post-conflict economic order

Post-revolution Tunisia captures the irony

WHAT SHIFTS THE SOCIAL CONTRACT?

Shifting the social contract is not just a matter of executive policy action:

Social contract is difficult to change when rulers are relatively unconstrained

In developed polities, the following have played an important role

Competitive pressures

Structural economic change

Technological changes and disruptions

Most Arab societies remain largely insulated from such influences

The role of three crucial factors:

History, Oil, Conflict