



CEF & Kuwait Investment Authority

Kuwait City

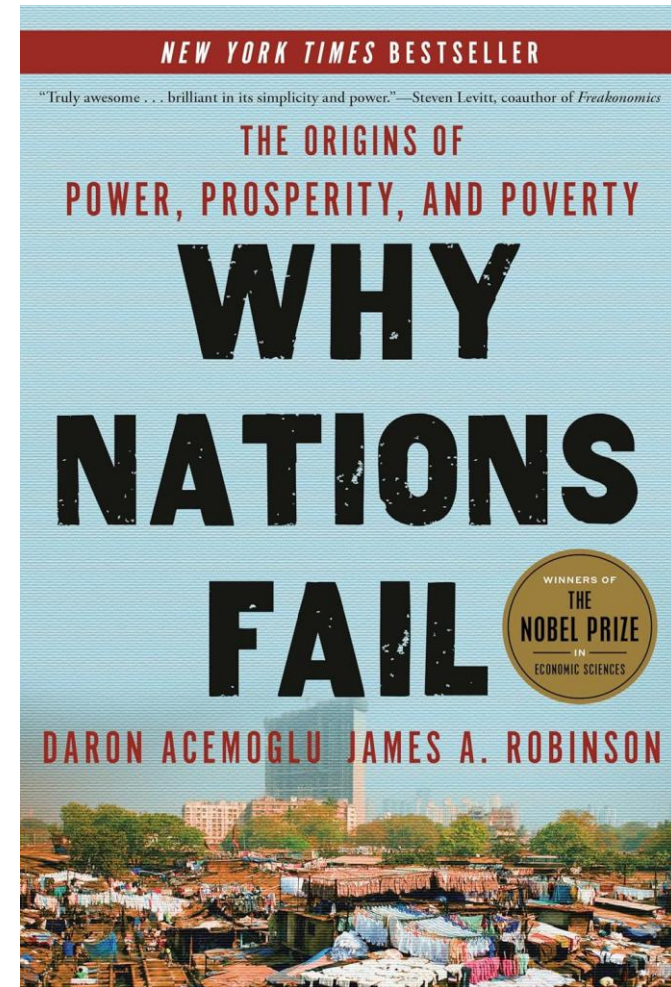
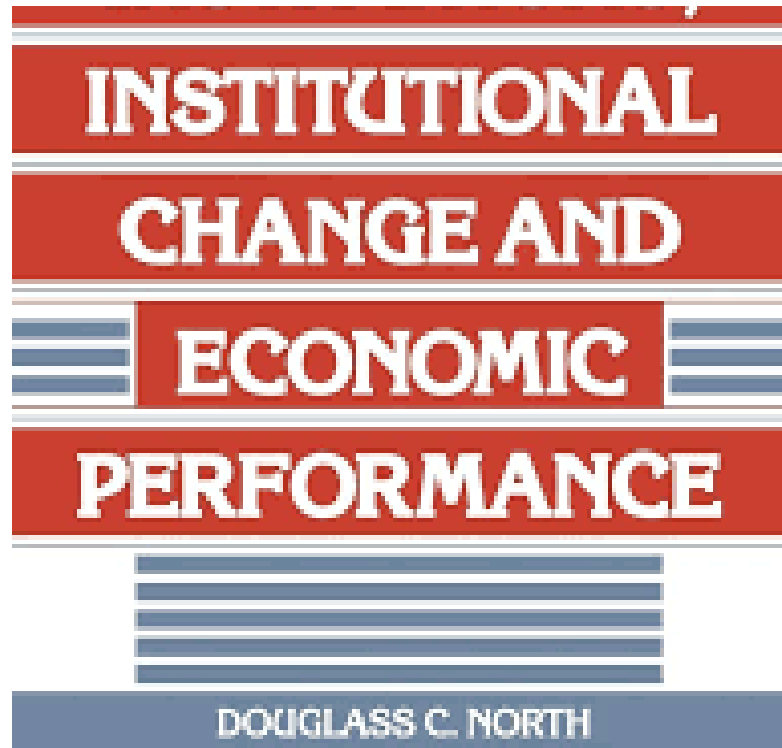
11 Nov 2025

Institutions for Growth and Development in the Arab World

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University of Oxford

Two Nobel prize winning economists highlight the primacy of institutions





Familiar institutional jargon

Good governance

Inclusive institutions

Rule of law

Government effectiveness

Control of corruption

State fragility

State capacity

...but

the relationship between institutions and economic development is not straightforward

Rather than focusing on “outcomes”, we ought to better understand the process through which these outcomes emerge

Political economy is about the “co-evolution of economic and political exchange”



Institutions as “Rules of the Game”

Institutions are the Rules of Game in a society or the humanly devised constraints that shape human interaction.

Why do we need institutions?

To reduce transaction costs to exchange

To lend predictability and reduce uncertainty to economic exchange

Inclusive vs. Extractive Institutions:

Key Idea: Nations thrive when institutions promote political and economic participation (inclusive institutions), but stagnate under extractive institutions where power is concentrated in the hands of elites.



Examples of 'rules of the game' in MENA

Muhasasa Ta'ifia

- Sectarian allocation of political and economic power in Lebanon and Iraq
- Quota-based system that entrenches clientelism, bloats the public sector
- Promotes 'politically-sanctioned corruption' and impedes genuine economic reform

Algeria's black market premium

- The gap between official and black market foreign exchange rate in Algeria is an important economic institution with far-reaching implications



The inseparability of economics and politics

Angus Deaton in the latest issue of F&D

“Our emphasis on the virtue of free, competitive markets and exogenous technical change can distract us from the importance of power in setting prices and wages, in choosing the direction of technical change, and influencing politics to change the rules of the game. Without an analysis of power, it is hard to understand inequality or much else in modern capitalism”

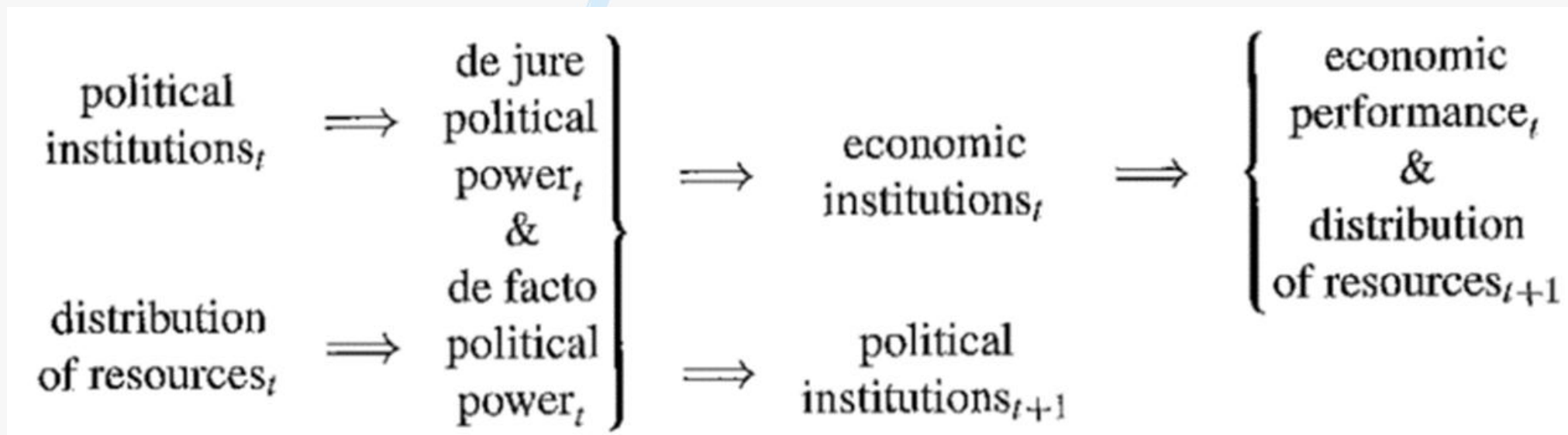
Jeffrey Frieden in F&D (2020)

“The policy that economic analysis indicates is best for the economy may not be politically feasible”



Power & Politics

The distribution of economic and political power determines the type of institutions a country has and their impact on economic performance





The social conflict view of institutions



Postulate 1

Economic institutions represent the interests of powerful groups in society

“...economic (and political) institutions are not always chosen by the whole society (and not for the benefit of the whole society), but by the groups that control political power at the time (perhaps as a result of conflict with other groups).”

Equilibrium economic institutions are “not...those that maximize the size of the overall pie, but the slice of the pie taken by the powerful groups”

(Acemoglu, p. 427)

Postulate 2

Efficiency considerations cannot be separated from distribution

Achieving efficient economic outcomes will have distributional consequences

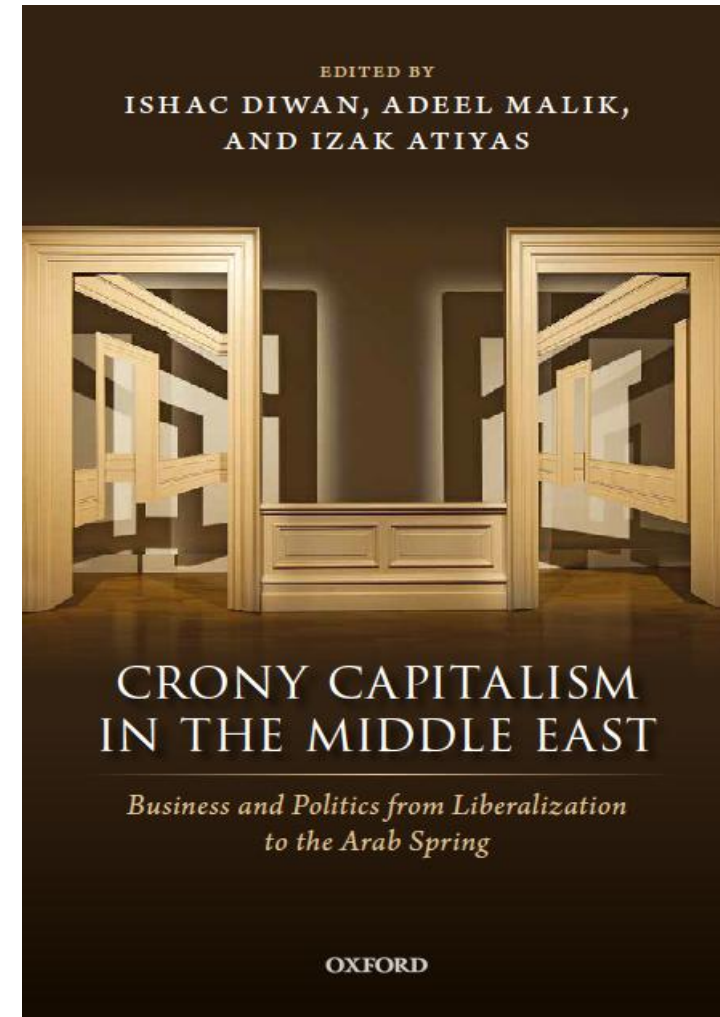
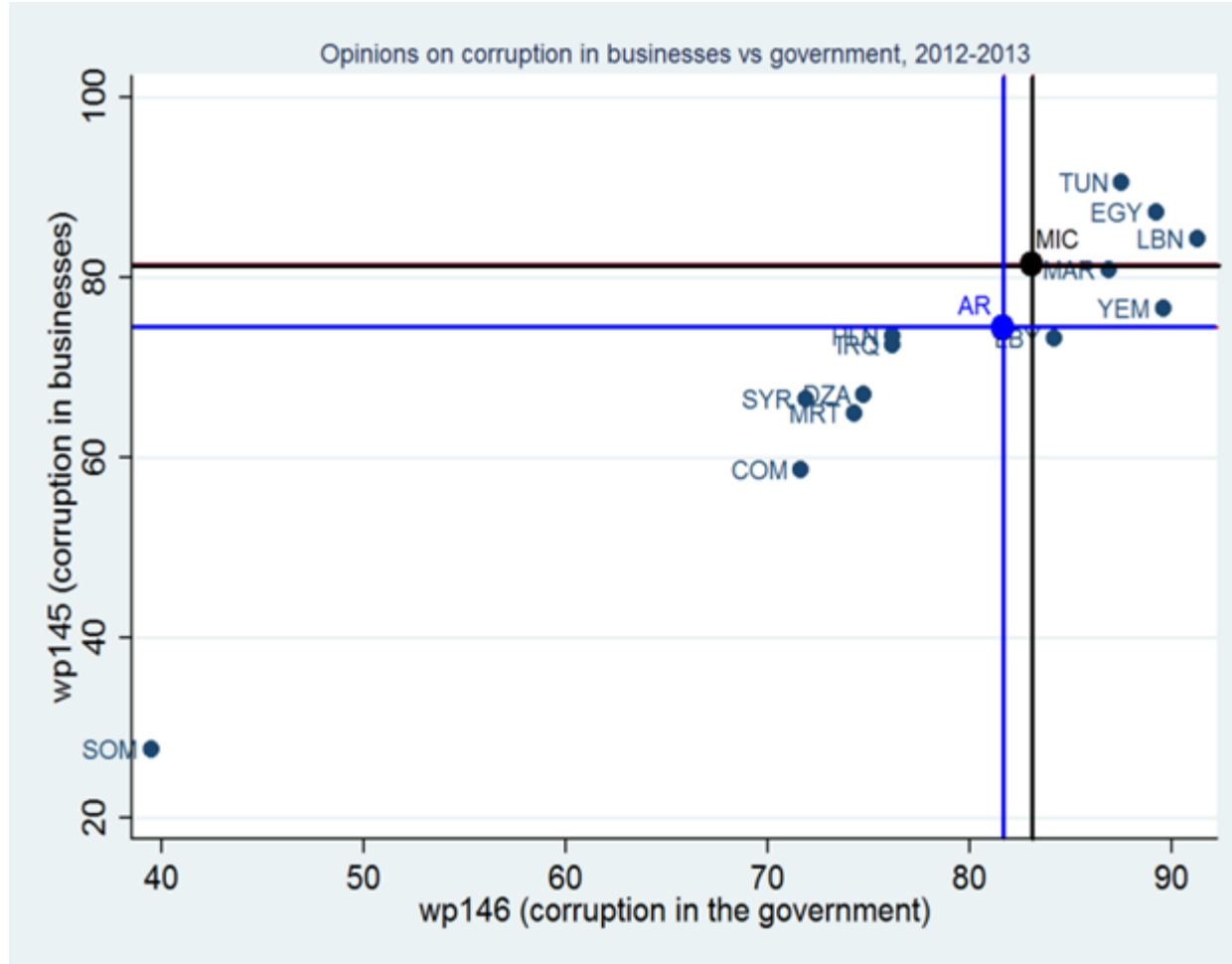
- Removing barriers to free trade => hurt politically powerful protectionist lobbies
- Eliminating inefficient tax exemptions => hurt privileged groups
- Economic diversification => creative destruction => destroys the old & creates new economic winners.



In short: economic reform can be politically disruptive

Crony Capitalism in the Middle East

Across the Middle East corruption in government and business is often perceived as the same



Why do inefficient institutions persist?

Bad economic policies are often good politics: they ensure that those policies continue to favour dominant groups in society

The possibly DISRUPTIVE consequences of economic reform

Removal of market failure => income distribution in society => political equilibrium

Acemoglu (2003) – Social conflict, commitment and politics

“... inefficient institutions and policies are chosen because they serve the interests of politicians or social groups that hold political power at the expense of the rest.”

The source of inefficiency lies in “Commitment problems”

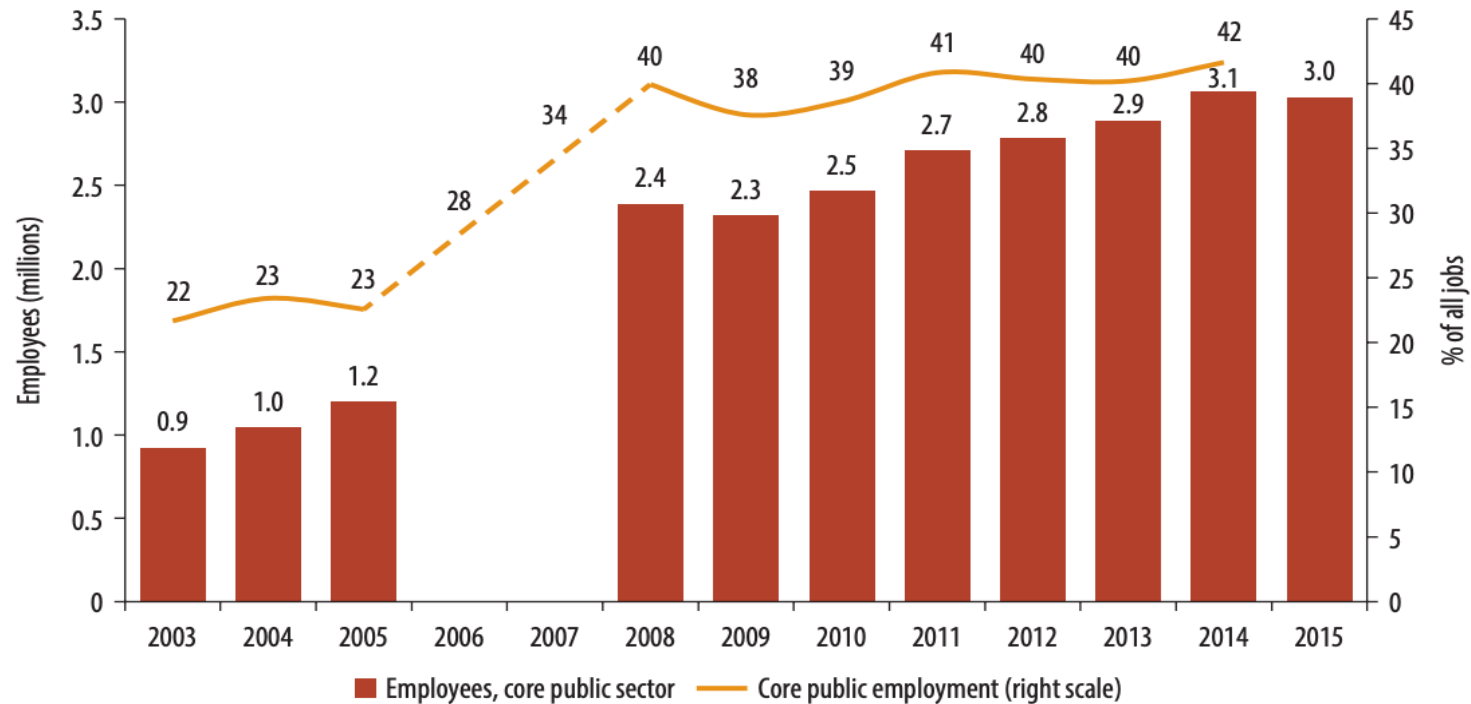
MENA country have long struggled to achieve the following

- Subsidy reforms
- Private Sector Development
- Economic Diversification

The distributive imperative of public employment is even stronger in fractured and conflict affected states like Iraq

FIGURE 1.6

Core Public Sector Employment in Iraq, 2003–15



Sources: Iraq Ministry of Finance data; World Development Indicators data, quoted in World Bank 2017b.

Public expenditure growth is underpinned by a distinct political logic

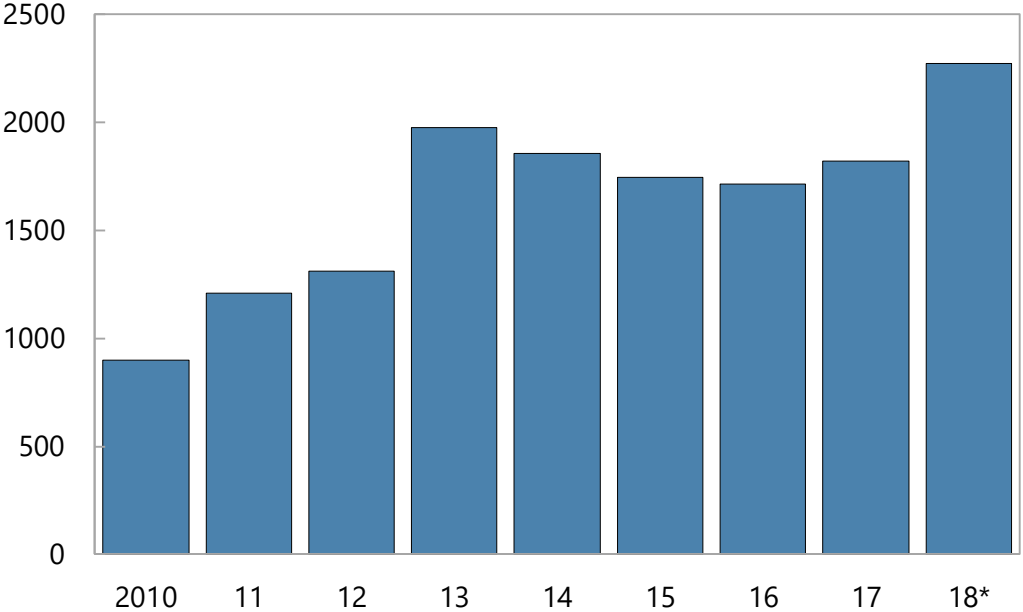
- Control over various line ministries is one of the prime means to control revenues of the state
- Clientelistic distribution of employment to respective support groups
- Uncontrolled growth of the wage bill, which is the single biggest item on the state treasury

Similar escalation in the wage bill in Libya and Yemen

Difficult to understand these macro-outcomes without appreciating the fragile and factional political settlements

Government Wage Bill, Libya 2010-18

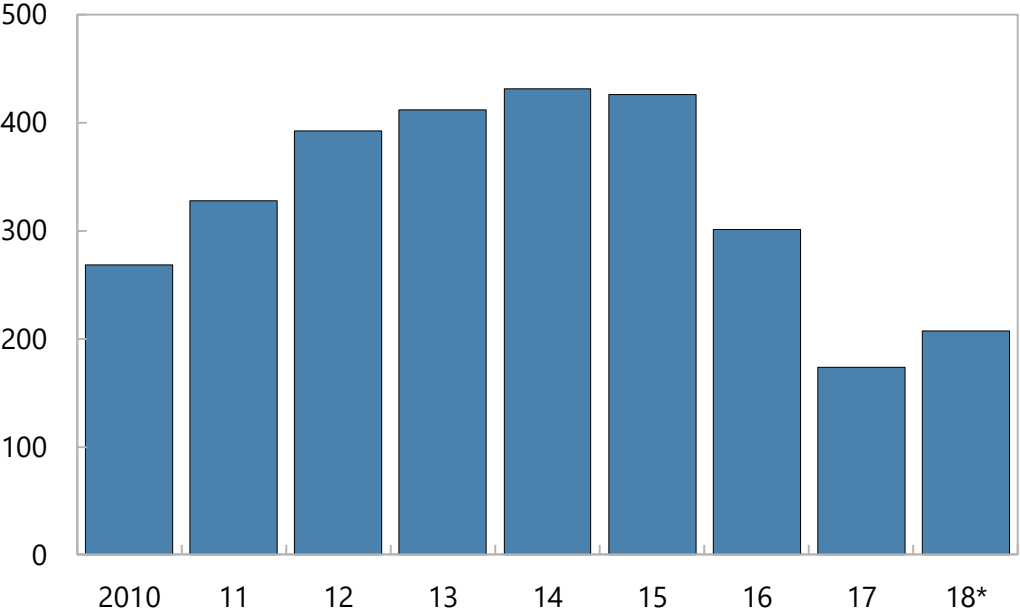
(US\$ Billions)



Sources: National Authorities; and IMF Staff Estimates. *Projected.

Government Wage Bill, Yemen 2010-18

(US\$ Billions)



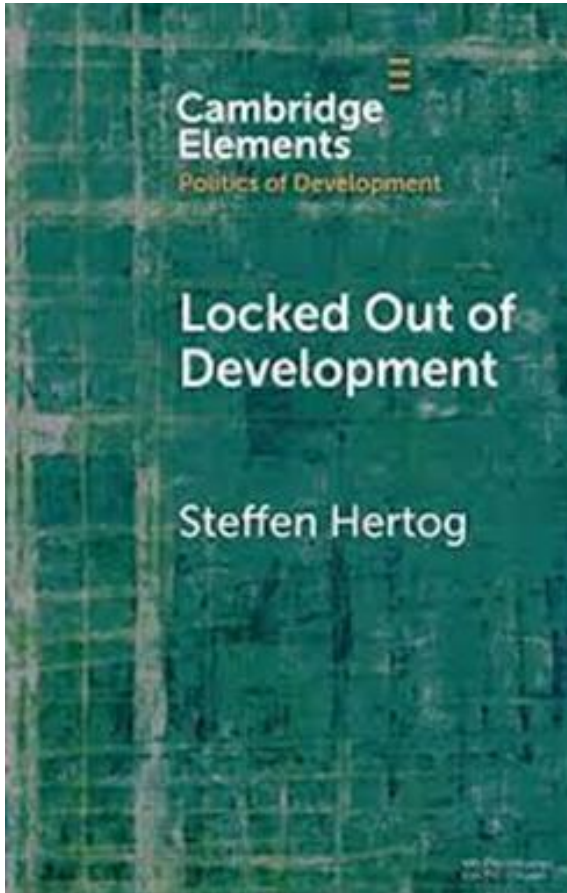
Sources: National Authorities; and IMF Staff Estimates. *Projected.



Another reason for the persistence of inefficient institutions:

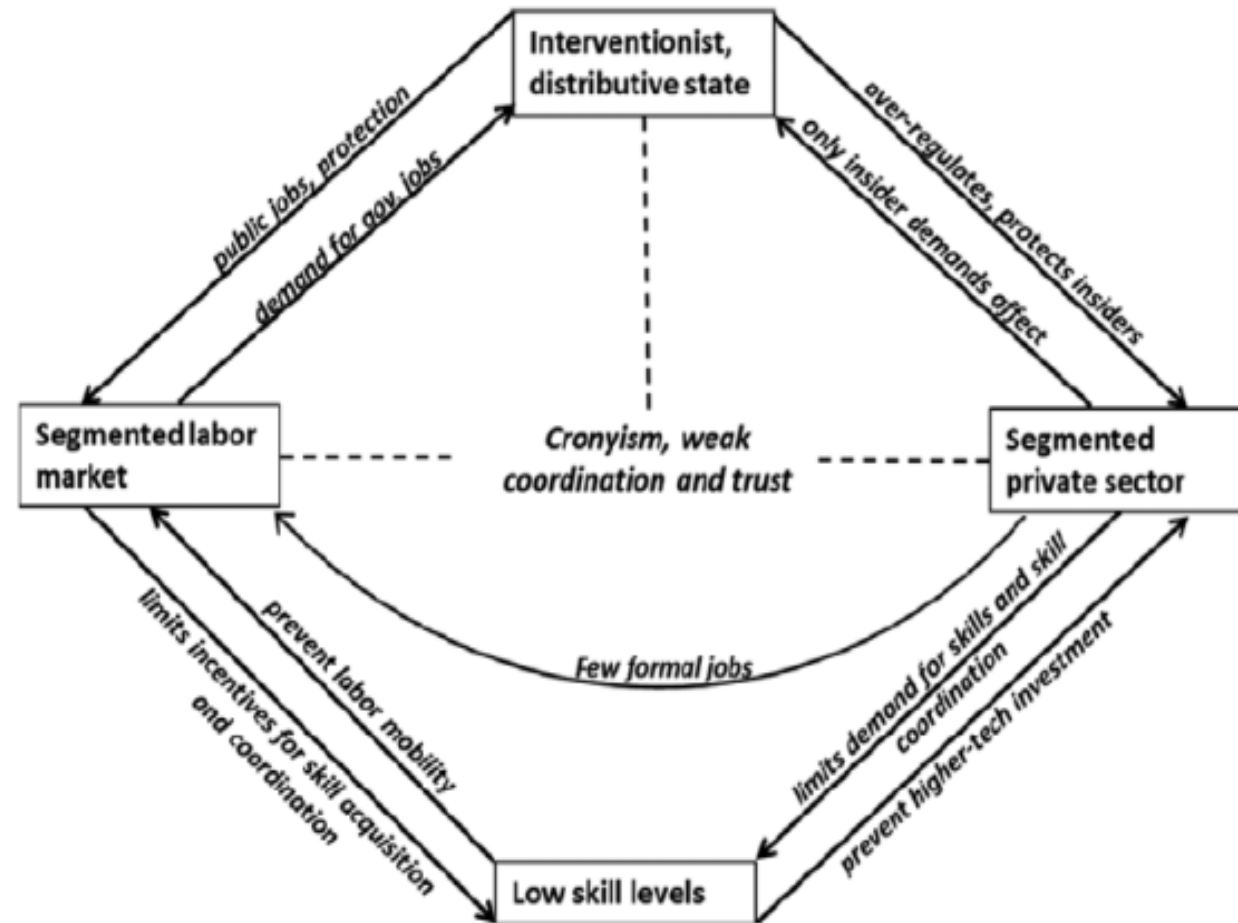
Weak institutions are often part of a vicious development trap

Mutually Reinforcing Feedback Loops of Underdevelopment



Locked Out of Development

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Elite incentives matter

Economic reform must be compatible with elite incentives

Constituencies and coalitions with direct stakes in the promotion of industry

Glorious revolution in England

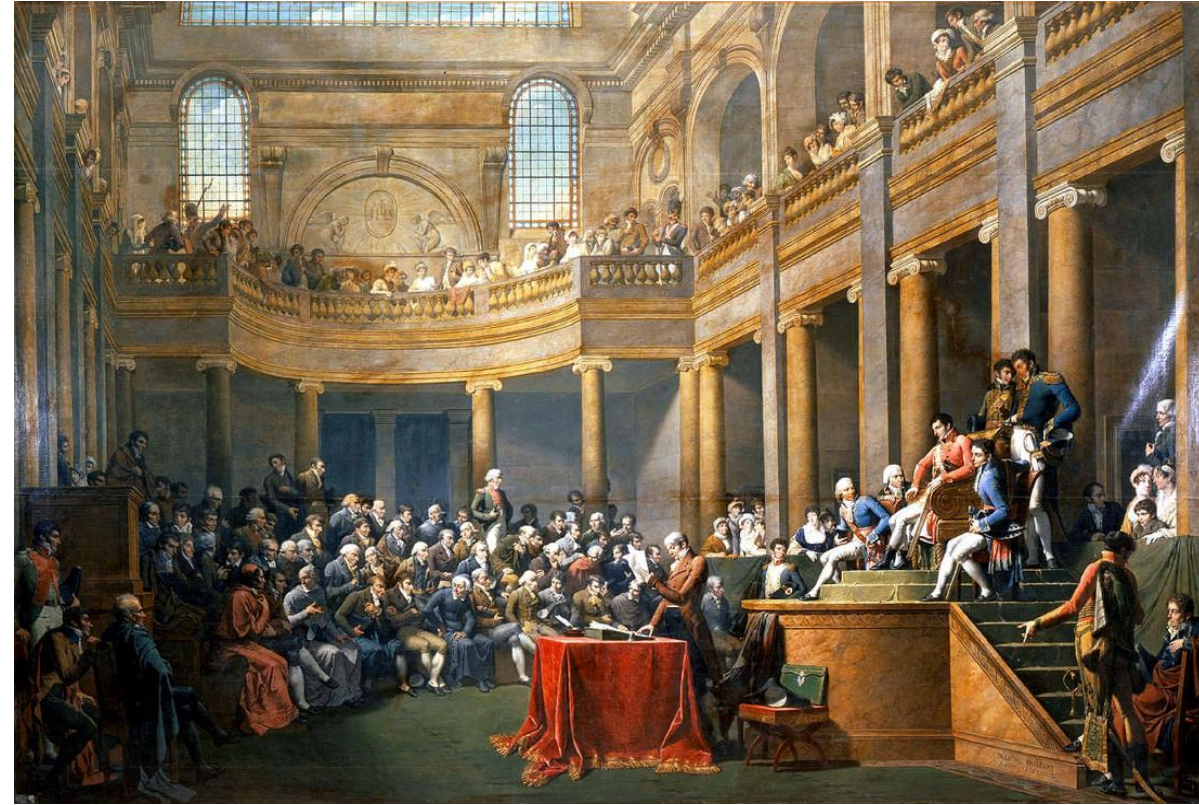
Whig coalition in England included politicians who owned factories and favoured policies that increased the value of their assets;

Chinese Communist Party

CCP remains an important stakeholder with a vested interest in expansion of the economic pie;

Turkey

Since the coming to power of Turgut Ozal, the balance of power has gradually shifted towards new political actors from Anatolia who directly benefit from economic growth





What shapes elite incentives?

Geo-political rents

External inflows in the guise of foreign aid and remittances can shape the incentives for reform

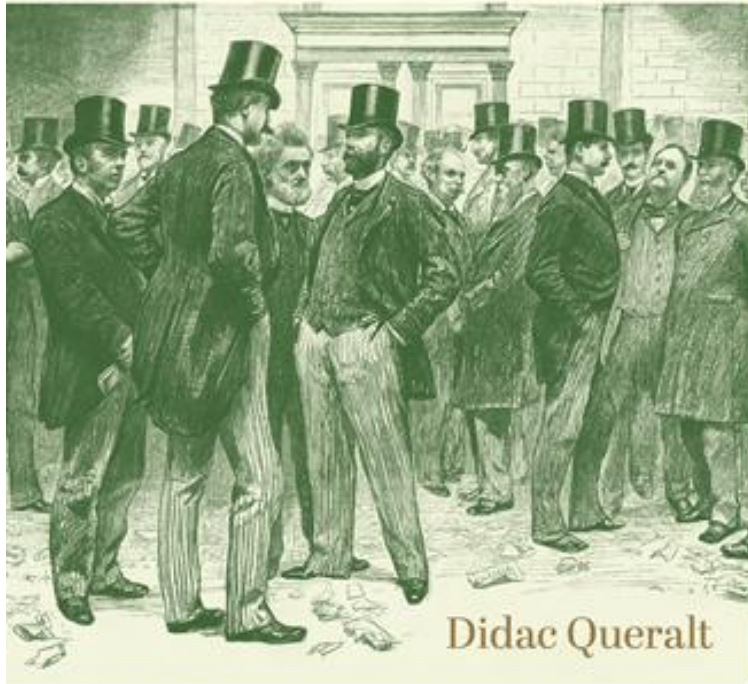
Availability of external credit shapes the rulers' incentive and can

- (a) attenuate balance of payments pressures at home
- (b) postpone reform and
- (c) reduce constraints on their power

“political game between foreign financiers, local incumbents, and taxpayers, and how early fiscal decisions shaped state building in the long run” (p. 3)

Pawned States

State Building in the Era of International Finance



The Perils of INTERNATIONAL CAPITAL

Faisal Z. Ahmed



Regional financial outflows are crucial for understanding political economy in receiving states

GCC states are by far the largest source of capital investment in the eight recipient case countries (when combined as a cohort):

Djibouti, Egypt, Ethiopia, Jordan, Oman, Pakistan, Sudan, and Yemen.

Changing nature of flows:

- Official development assistance
- Central bank deposits
- Deferred oil payments
- Foreign direct investments

Increasingly coordinated with other multilaterals, such as the IMF, WB, ADB, IDB, etc.

Data source: <https://www.aei.org/multimedia/fadi-tracker>.

Gulf Financial Aid and Direct Investment Tracker (FADI Tracker) by Source Country 2003 to July 2021

Year (All) Destination (All) Category (All) Sub-Category (All)

Amount: ≤ \$500.0M ≤ \$20,000.0M ≤ \$40,000.0M ≥ \$60,000.0M

Bahrain



Kuwait



Oman



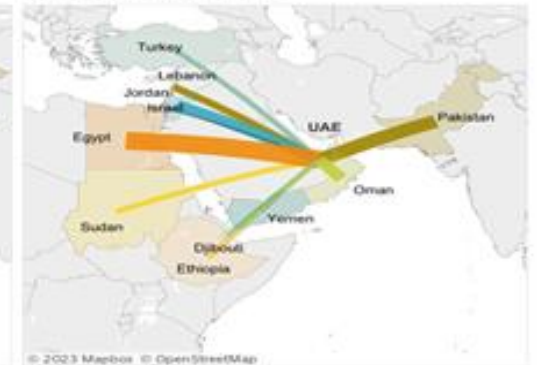
Qatar



Saudi Arabia



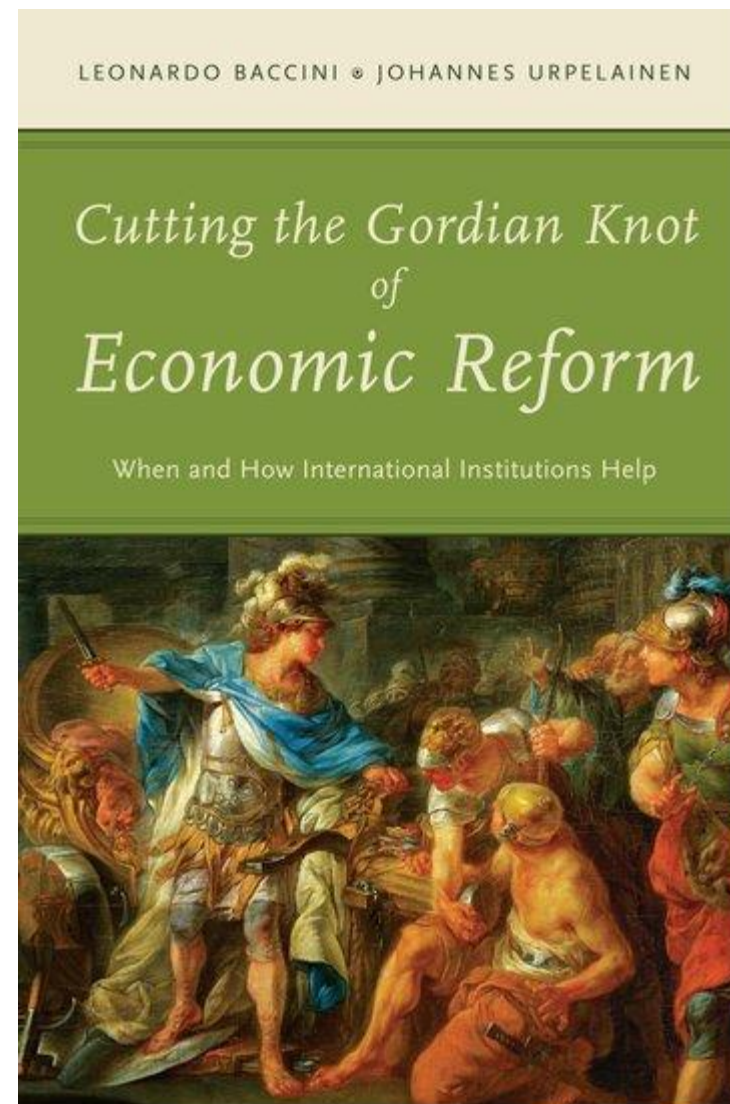
United Arab Emirates



Source: "IDI Markets", <https://www.idimarkets.com/> and Author's research.

Economic Reform often requires commitments and compensation

- How to credibly commit power holders to pursue reforms that are otherwise not politically viable?
- Role of external anchors (e.g. Free Trade Agreements): credible policy commitments can be enabled by international institutions
- FTAs can tie the hands of rulers vis-à-vis domestic constituencies who oppose reform (e.g. protectionist lobbies).
- New and unestablished leaders are more likely to back reform as they need a new coalition of supporters

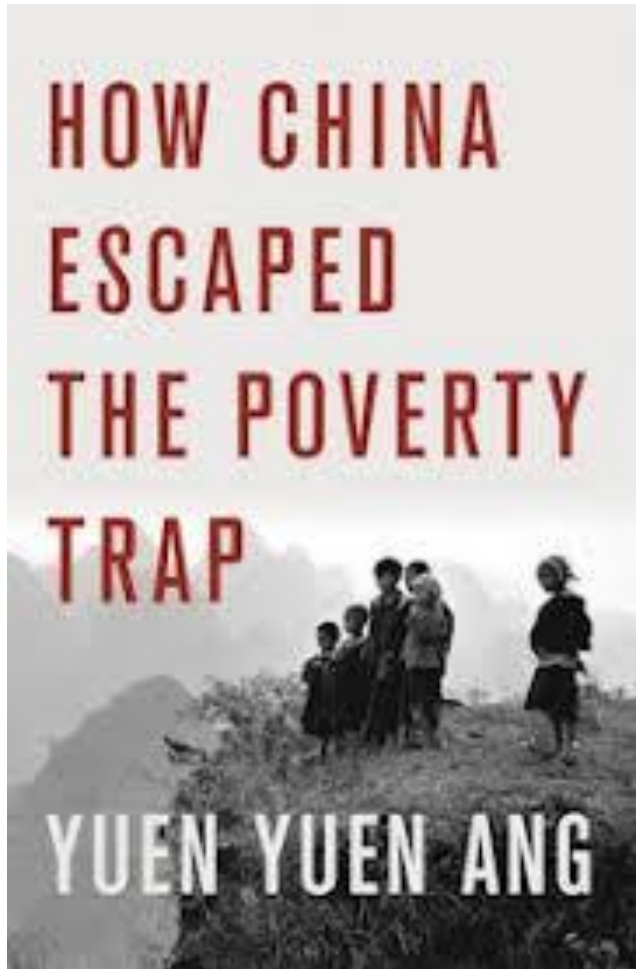




Good institutions are sometimes created in the process of economic development

Economy as an adaptive system where markets and institutions co-evolve

Building on what you have



ADAPTIVE POLITICAL ECONOMY

13

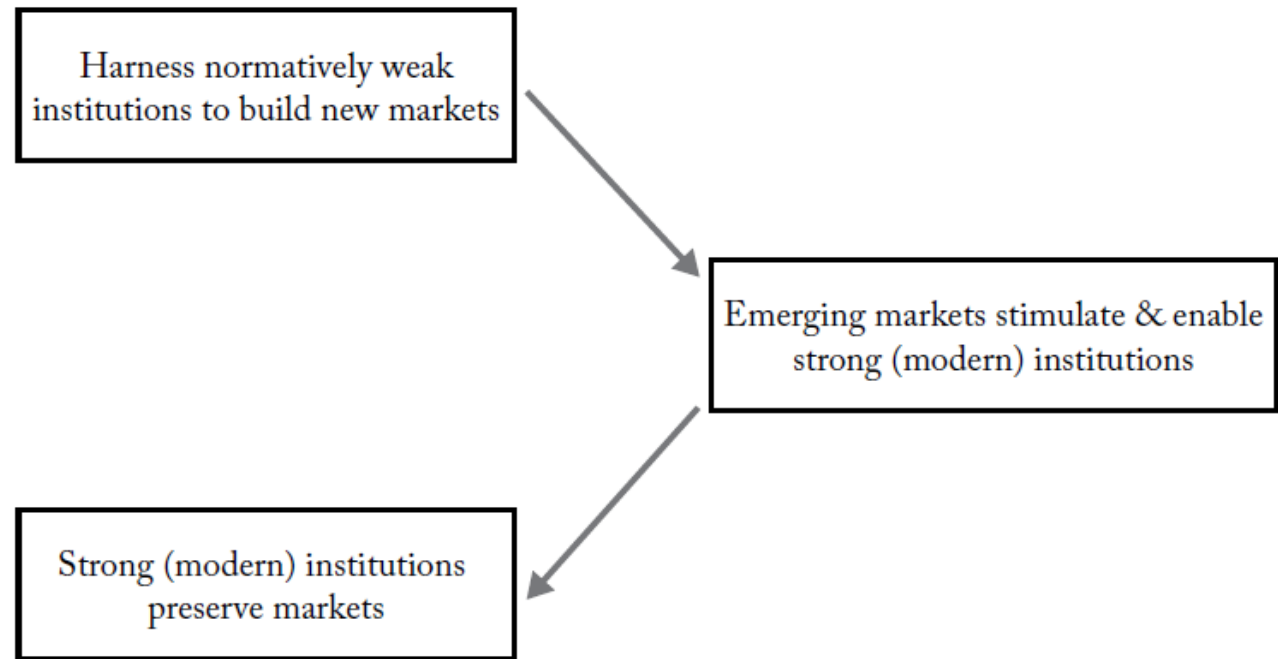


FIGURE 3
DEVELOPMENT AS A THREE-STEP, COEVOLUTIONARY PROCESS



Geopolitics as the blind spot of modern political economy

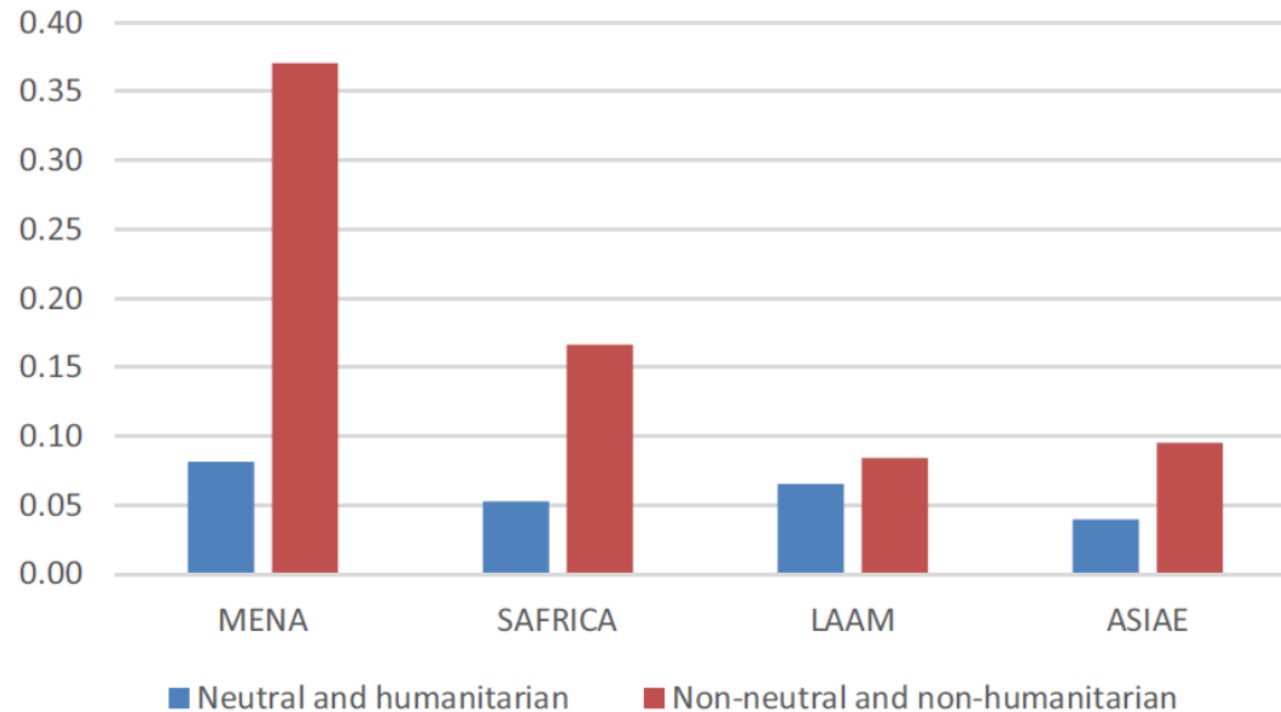
The “Violence Trap” reinforces weak institutions in MENA states

The Middle East remains one of the most conflict prone regions in the world

High incidence of civil conflict despite moderate levels of ethnic and religious polarization

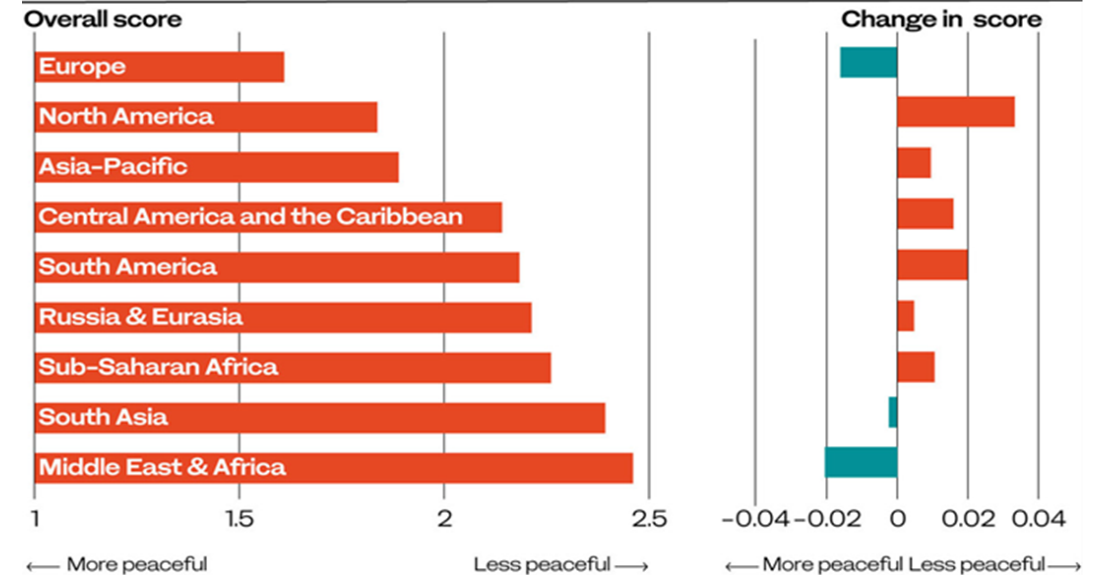
“Unlike in the rest of the world where civil conflict is mostly driven by identity concerns about ethnicity, in MENA it is mostly associated with foreign interventions which intensify religious polarization through intergroup alienation”

(Source: Abu-Bader and Ianchovichina 2018, 13)



GLOBAL PEACE INDEX 2021 RANKING BY REGION

MENA remains the least peaceful region, but saw the most improvement on last year



Source: Institute for Economics and Peace (IEP)

ARAB NEWS

Fig. 1. Distribution of Military Intervention Frequency by Type and Region.
Data source: IMI data (Pearson and Baumann, 1993).

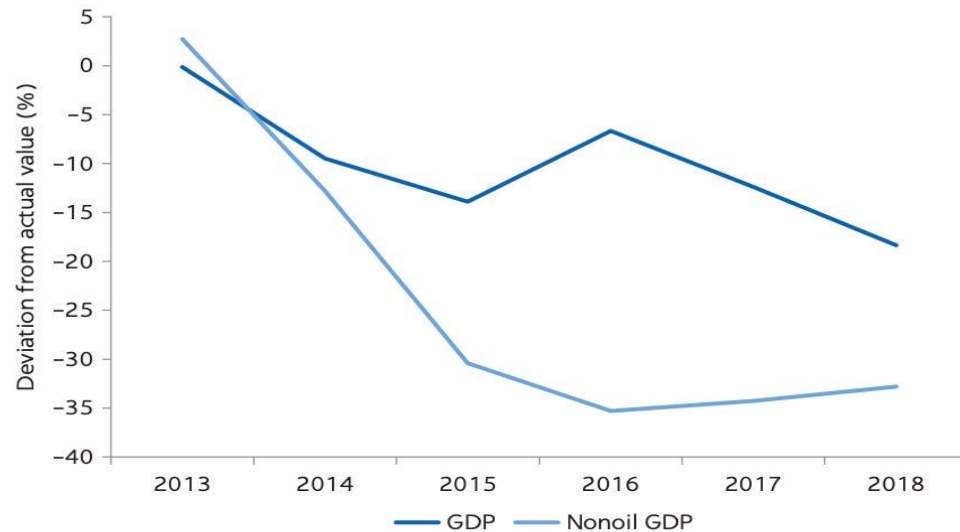
Conflict-induced growth collapses

Syria: GDP is two-thirds lower after the war
(Source: World Bank 2017)

Yemen: GDP is less than half of what would have been in the absence of war
(Source: UNDP 2020)

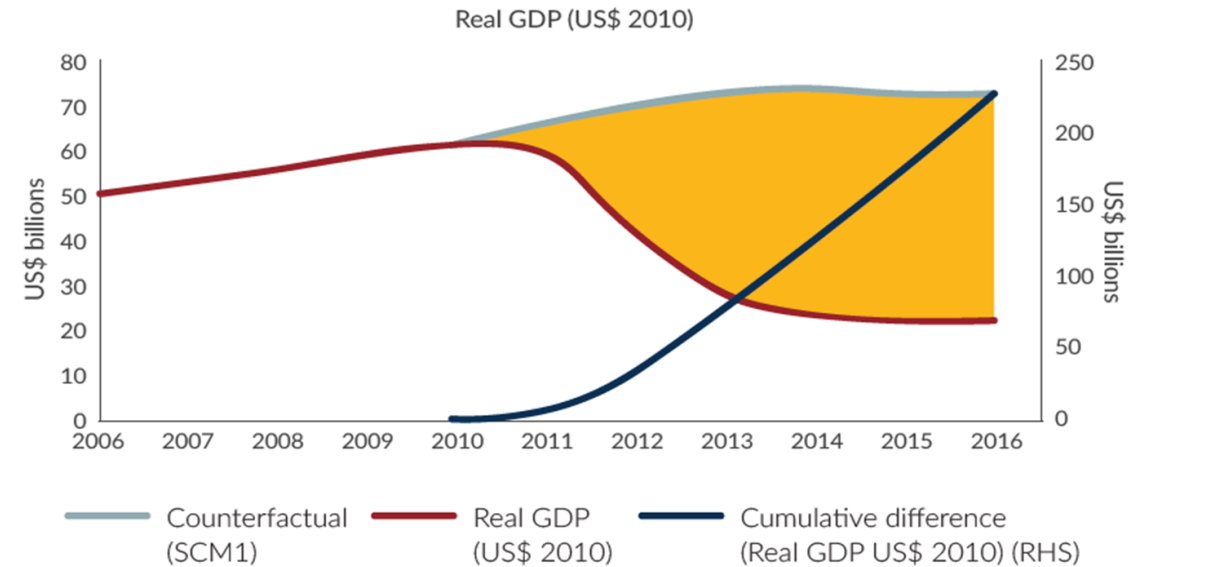
FIGURE 0.2

Iraq has suffered staggering GDP losses because of ISIS

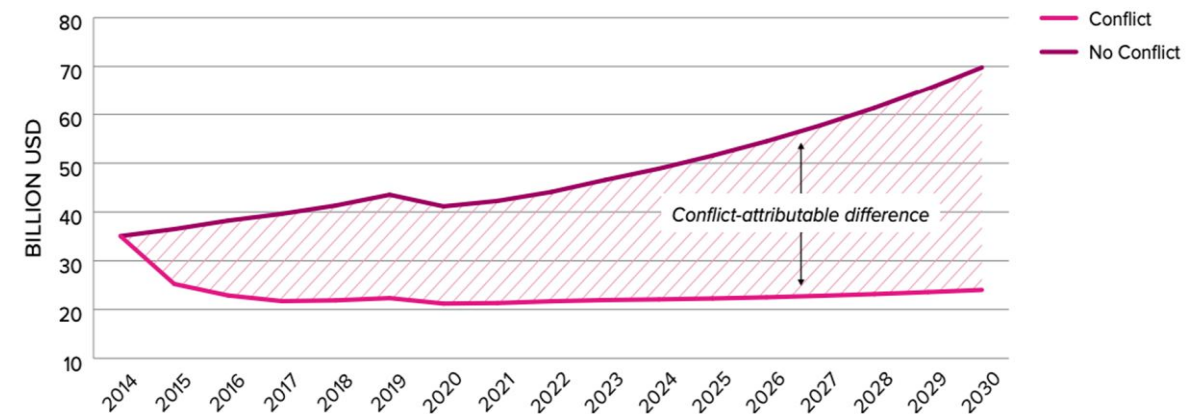


Source: World Bank staff estimates using the synthetic control method.
Note: GDP = gross domestic product; ISIS = Islamic State of Iraq and the Levant.

Figure 3.3: Actual and Counterfactual GDPs and Cumulative GDP Losses



GDP (MER) in Yemen across scenarios



Violence reduction requires greater economic complexity and specialization.

Cox, Wallis, and Weingast
The Violence Trap

NORTH et al. (2014):

Multiple exchange relationships bind the interests of all involved => since they increase the cost of violence.

Increasing returns problem of the control of violence

- But reformed economies are not possible without reformed politics

Middle East is one of the least integrated regions

- A typical MENA country exports less than half, and as little as one-quarter, of its potential even after taking account of standard determinants of trade



Arab Integration

A 21st Century Development
Imperative



Much focus on new political and sectarian borders
without any economic vision

Needed:

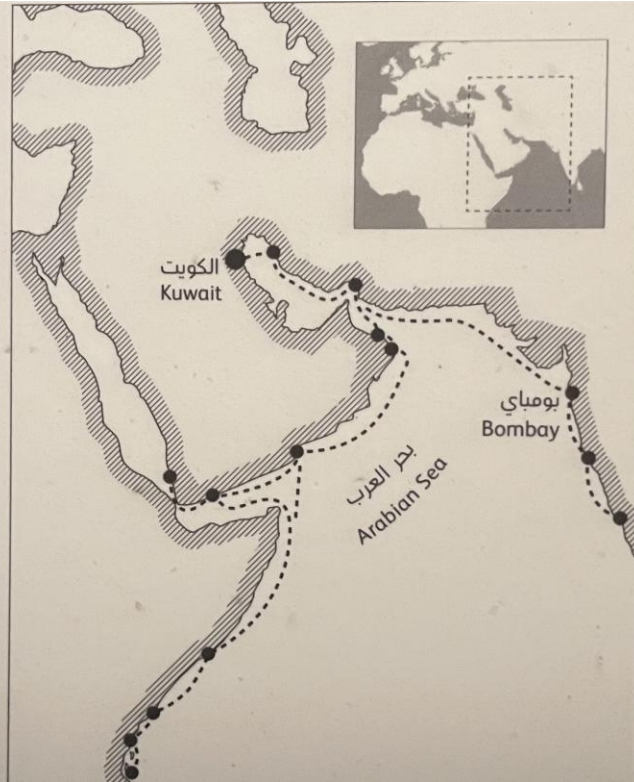
A new regional economic order that replaces the
spoils of war economy with income from trade and
development

Two key challenges:

- Weak domestic constituency for regional economic integration => protectionism favours “small and cohesive” groups at home.
- A divided region maintains the “extractive” geo-political equilibrium

Trade Routes by Sea

Looking east, Kuwait developed a lucrative trade with Bombay and other Indian ports. By sea came timber, sail cloth and iron for ship-building in Kuwait, plus rice, sugar and spices for sale in Arabia and beyond. In exchange went Arabian horses, dates and pearls. Kuwaiti ship also traded down the east coast of Africa and around the ports of southern Arabia.

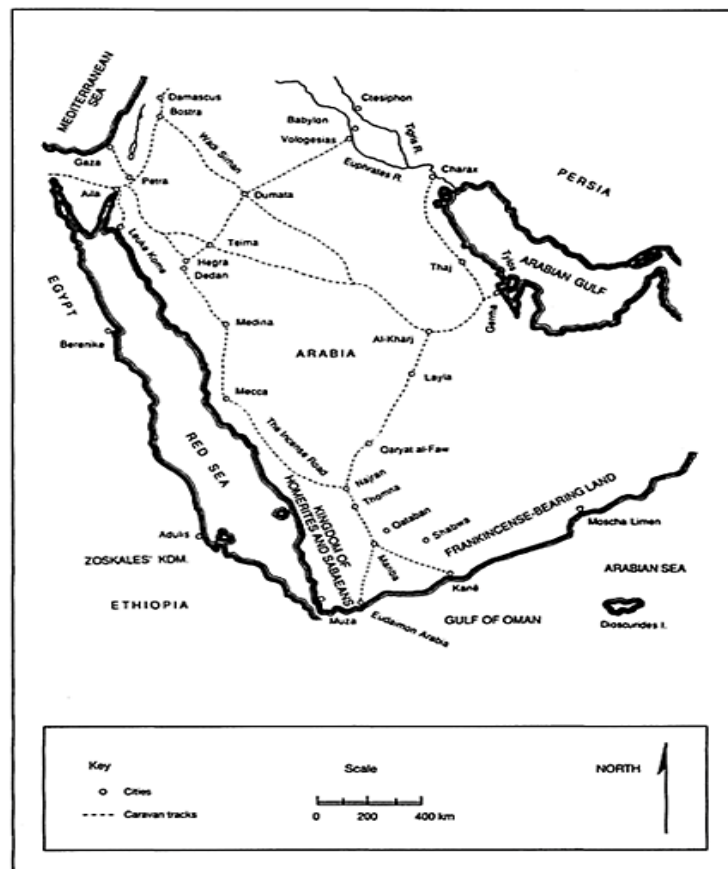
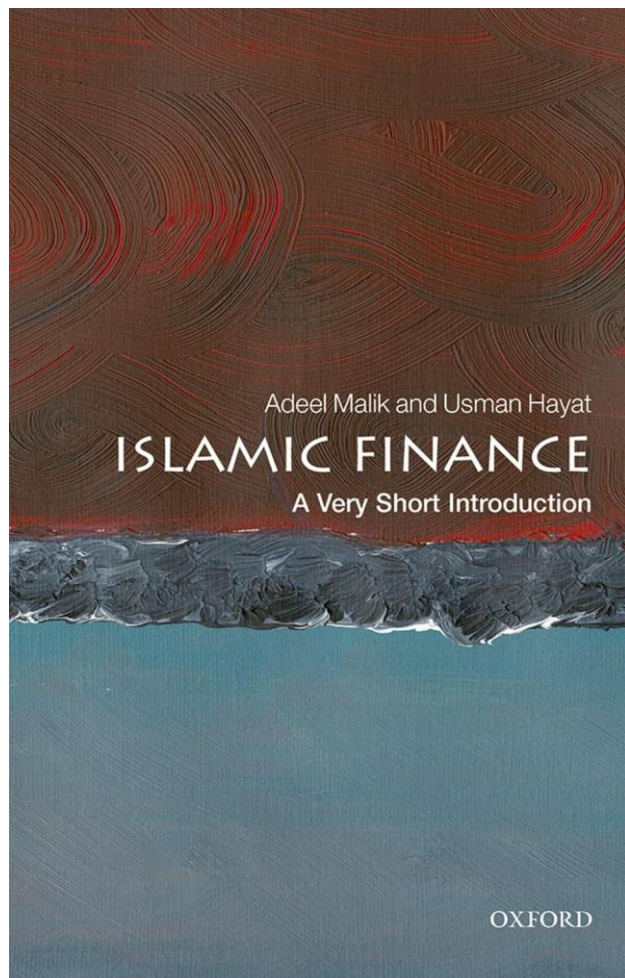


The road to the future runs through the past

Kuwait provides an excellent illustration:

- The pre-oil economy of Kuwait was inserted into regional circuits of trade, spanning from Aleppo and Basra to Bombay and East Africa.
- “The inhabitants of Kuwait like those of Venice took chiefly to maritime pursuits”

Ideas matter:
Lesson from the Moral Economy of Islam



Map 3.1 Caravan tracks of the Arabian Peninsula—showing the major caravan tracks in use in the first centuries B C and A D which are discussed in the text. Titles of kingdoms are those used in the *Periplus*

From *Hilf* to *Ilaf* to *Islam*

How the institutional equilibrium of pre-Islamic Arabia transformed from robbery and raiding to an expanded and mutually beneficial trade



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