



United Nations
Economic Commission for Africa

Accounting for slow productivity growth in North Africa: the role of policy distortions

Key messages

- Developing and emerging market countries suffer from distortions that originate from market and government failures, which may be mutually reinforcing
- In North Africa, such distortions are potentially a significant impediment to structural transformation and total factor productivity growth
- Addressing government failures is critical for the efficient design and implementation of public policies
- Important recommendations to reduce policy failures are:
 - In the design of policies: transparency, inclusion, evaluation and monitoring, and increasing the capacity of policymakers
 - In the implementation of policies: transparency, accountability and impartiality, and anti-corruption

I. Introduction: government failures and productivity

As Thomas Hobbes stated in *Leviathan*, life without an effective State to preserve order was “solitary, poor, nasty, brutish and short” (Hobbes, 2008). The State is fundamental not only in preserving order, but also in other dimensions that govern life in society. Philosophers, political scientists and social scientists have always debated, at least as far back as ancient Greece, on the role of the State and on the mutual rights and obligations of States and citizens. Debates within the development economics profession have been animated by the dualism of markets versus the State. The idea that the market is the best place for promoting economic growth and more generally for improving well-being goes back to Adam Smith (1909) in his book *An Inquiry into the Nature and Causes of the Wealth of Nations*. Within this view, the role of the State should be to provide public goods and enforce contracts, which is essential to the functioning of the market. However, many conditions are required for that statement to hold true. The fact is that there are no perfectly competitive markets, in which prices play their role in efficiently allocating resources within the economy. With the influence of many important events, such as the two world wars, and in particular the Great Depression, which led to the emergence of the Keynesian revolution, the idea of the omnipresence of market failures (with widespread externalities) paved the way for a greater role for the State. In his big push theory, Rosenstein-Rodan (1943 and 1961) emphasized the problem of coordination failures in the process of economic development and strongly underlined the important role of the State in such development.

The widespread intervention of the State in many dimensions of the economy in both rich and poor countries has had a negative impact on the functioning of markets. In most African countries, for example, growth performance has been quite disappointing, to the point when economists spoke

of “a growth tragedy” in African countries (Easterly and Levine, 1995). In the 1980s, slow growth and high poverty rates in African countries were then attributed to excessive and inappropriate government intervention in the economy (Adjei, Kyei and Afriyie, 2014). North African economies have also experienced relatively slow productivity growth compared with other developing countries (United Nations, Economic Commission for Africa, 2021).

The 1980s witnessed a shift to concern about so-called “government failures” and towards more market-friendly policies. If markets can fail, so can Governments. As there is no perfectly competitive market, there are also no perfectly benevolent politicians who can fix market failures. In public choice theory, it is argued that Governments are populated, at least partly, by people motivated by self-interest. Moreover, in public choice theory, sources of inefficiency in government decision-making processes themselves are identified. Excessively interventionist policies can create regulations, rent-seeking behaviour and corruption that lead to “policy failures”, that is, a policy through which Pareto-optimum outcomes are not delivered. There are two situations relating to policy failures: one in which government intervention leads to an outcome that is less efficient than if the Government hadn’t intervened, and the other in which a Government’s failure to intervene leads to a Pareto-inferior outcome.

There is a strong consensus that an active role for the State is critical to successful economic development, and the experience of East Asian countries shows that.¹ A fundamental task is to define the limits of State intervention and, within those limits, to engage in interventions that contribute to welfare.

Market failures are significant, even in developed countries (the financial crisis that began in 2008 is an example), but they are much more so in developing countries. They face missing markets, imperfect information and markets that are not well functioning, all of which have significant effects on the economy. Market failures create distortions that prevent the efficient allocation of resources. However, developing countries suffer also from government failures, whose impact can be of first-order magnitude.

In public policy, there is no perfect solution to a problem, and a technical solution can often be diluted in political considerations. Moreover, the existence of a market failure doesn’t mean that government intervention, even if properly implemented, will lead to a better outcome. Public policy is subject to the nirvana fallacy, as introduced by Demsetz (1969): “The view that now pervades much public policy economics implicitly presents the relevant choice as between an ideal norm and an existing ‘imperfect’ institutional arrangement. This nirvana approach differs considerably from a comparative institution approach in which the relevant choice is between alternative real institutional arrangements.” In conducting policy, bureaucrats should examine alternative policies and institutional arrangements to select feasible policies that can lead to the best outcome.

An active industrial policy can be taken as an example that highlights the complex nature of State intervention and its potential distorting effects on the economy. Although the implementation of industrial policies may be justified in cases of market failures, those policies may result in

¹ The remarkable development of East Asian economies can be significantly attributed to the critical role of the State, which strategically orchestrated industrial policies, guided investments and fostered robust public-private partnerships to accelerate technological innovation and economic growth. See, for example, Stiglitz and Yusuf (2001).

government failures when they target specific sectors, activities or even firms and thus contribute to the misallocation of resources.

That can be helpful when considering development issues in North Africa. In developing countries, structural transformation is a primary engine of productivity growth. In analysing the development path of North Africa, weak and slow structural transformation (although with some heterogeneity between countries) is a striking feature of the subregion (United Nations, Economic Commission for Africa, 2019)). Understanding the reason behind that is critical, and there are many views or alternative explanations for it. Countries in North Africa, as almost all developing countries, suffer from various market failures. At the same time, State intervention is pervasive. Two legitimate questions arise: (a) Is State intervention addressing market failures? and (b) To what extent is State intervention in the economy subject to government failures? In the present policy brief, the impact of government failures on productivity in North Africa is addressed. Some papers and reports have contained analyses of the impact of government failures on economic development in many areas in the world, including the Middle East and North Africa.

The case of the political influence of firms in generating inefficient policies (and thus generating potential distortions) has received some attention in the literature. In looking at transition countries, Hellman, Jones and Kaufmann (2000) documented that “large incumbent firms with formal ties to the state tend to ... enjoy more secure property and contractual rights and higher growth rates”. They sometimes even manage to gain influence over the State, resulting in changes to laws and regulations that disadvantage their competitors. With regard to North Africa, the existence of crony capitalism was documented in studies on Egypt and Tunisia. In the case of Egypt, Diwan, Keefer and Schiffbauer (2016) documented that, under the Mubarak regime, crony firms enjoyed multiple regulatory and fiscal privileges that reduced competition and investment by non-crony firms. Acemoglu, Hassan and Tahoun (2015) illustrated that, during the Arab Spring in Egypt, intensified protests in Tahrir Square negatively affected the stock market valuations of firms linked to the ruling faction, with social media playing a crucial role in mobilizing protesters, thereby showcasing that, in settings with frail institutions, public mobilization and protests could hinder connected firms from garnering excessive profits. In the case of Tunisia, Schiffbauer and others (2014) reported that politically connected firms (those connected with the Ben Ali family) outperformed their competitors in terms of employment, output, market share and profits. Moreover, the sectors in which they operated were disproportionately subject to authorization requirements and restrictions on foreign direct investment.

Finally, structural transformation is also critical for a just and sustainable transition in developing countries (United Nations, Economic Commission for Africa, 2024), and in particular in North Africa, which is one of the geographical areas the most affected by climate change (United Nations Framework Convention on Climate Change, 2023). Moreover, the process of a just and sustainable transition is highly subject to both market and government failures.² That is another reason why, in conducting appropriate governance reforms and public policies, it is critical for Governments to better understand the nature of distortions originating from government failures.³

2 By their very nature, there are many externalities generated by both inaction and action in favour of transition. In the case of climate action, for example, the slow pace of progress can be attributed to the forces of inertia (such as the pressure exerted by interest groups whose assets would depreciate). It should be noted that the urgency of the situation makes it difficult to implement public policies, given the uncertainty surrounding the impact of climate change, the capacity of countries to adapt and the lack of hindsight in the public policies to be implemented.

3 Governance reform is more generally an urgency at the global level, for humanity to be able to address the challenges of climate change and other pressing global challenges (such as migration and artificial intelligence).

In the present policy brief, the potential effects of distortions in North Africa on total factor productivity are documented. In section II, governance and policy failures are briefly discussed. Evidence on the cost of distortions in North Africa is presented in terms of total factor productivity through two channels: firm productivity and human capital accumulation. Section III contains a discussion on how to address policy distortions and policy recommendations.

II. Governance and policy failures

State interventions are done within a governance framework, and the ability to deliver good outcomes through policies is closely linked to the quality of governance. Both governance and its quality are hard to define, and there are many definitions. For example, for governance, there are definitions in which democratic outcomes are used (such as accountability), whereas in others they are not. The quality of governance may be even harder to define. The definition by the World Bank is quite broad, using six indicators, some of which cover dimensions of the political system. To analyse governance independently from the political regime and determine how political institutions have an impact on governance, a “neutral” definition is required.

The definition by Fukuyama (2013) meets that objective; she defines governance as “a government’s ability to make and enforce rules, and to deliver services”. In that definition, the interaction between State capacity and bureaucratic autonomy as a proxy for the quality of governance is stressed. State capacity is clearly an important dimension of the quality of governance for some obvious reasons. For example, if civil servants do not have the necessary skills, they will not be able to design policies that can increase welfare. Or, if a Government lacks resources, that could also be an issue for implementing policies, or for having them reach their target. La Porta and others (1999) found that better performing Governments were larger and collected higher taxes.

The autonomy dimension is more subject to debate, and there may be a U-shaped relationship between autonomy and the quality of governance. Zero autonomy means that a bureaucrat must strictly follow detailed rules defined by the political principal, which may be suboptimal. An example would be a bureaucrat having to comply with rules written by a non-benevolent political principal pursuing private interests. In the opposite case, bureaucrats who have complete autonomy escape any control from the political principal (and thus any political constituency) and pursue their own interests. Whatever the definition of governance, it is “about the performance of agents in carrying out the wishes of principals, and not about the goals that principals set” (Fukuyama, 2013). If a principal pursues goals that are not aligned with collective well-being, then policies will not necessarily be defined so as to increase welfare. For example, if firms can benefit from political connections, they may interfere in the decisions of bureaucrats, as long as the private interests of the political principal is aligned with those of those firms and the bureaucrats have sufficient discretionary power to implement policies that favour them. Political institutions can shape the objectives of a Government: a non-democratic Government may implement policies to favour the interests of a narrow group in society. That shows that it is difficult to link policy outcomes to the quality of governance.

The present short discussion demonstrates that, whichever definition of governance is used, policies are the outcome of complex interactions between political institutions, governance and markets.

There are two dimensions to consider when looking at the impact of policies. The first one, which was discussed above, is the quality of the policy, which refers to its efficacy in terms of solving a problem and delivering a better outcome in terms of welfare. The second dimension is the quality of the implementation of the policy, which in fact covers many dimensions, in particular what Rothstein and Teorell (2008) consider as a better proxy for the quality of governance, namely, impartiality in the exercise of governmental power. The predictability of government actions and information about what government bureaucrats can and cannot do, which are linked to impartiality, are central for economic agents. Rothstein and Teorell (2008) define impartiality as “when implementing laws and policies, government officials shall not take into consideration anything about the citizen/case that is not beforehand stipulated in the policy or the law”. A lack of impartiality, or partiality, is a form of government failure that can have a negative impact on welfare.

As stated in the introduction, developing countries are more subject to market failures, but evidence on the quality of governance (as measured by many indicators; see table 1) shows that they are also subject to potentially significant government failures. The interaction of market and government failures creates various distortions that impede the efficient allocation of resources, which may have a significant impact on productivity. The following section contains two quantitative assessments of the impact of distortions on productivity in North Africa. A recent report of the Economic Commission for Africa (2019) contains an examination of the role of distortions in explaining the weak contribution of structural transformation to labour productivity growth in the subregion. As stated in the report, distortions in financial and labour markets are potentially widespread in North Africa and are an impediment to structural transformation. Country scores on various indices on governance efficiency are presented in table 1. Comparisons are made among countries in North Africa and others.

Table 1: cores on indices measuring governance efficiency: a comparison among countries in North Africa and a sample of other countries, 2017–2020

	Corruption Perceptions Index (2019), rank of 180 countries	Worldwide Governance Indicators (2018), maximum score = 100	International Crisis Group indicators on bureaucratic quality (2017), maximum score = 4	World Economic Forum: Institutions of 141 countries	Ibrahim Index of African Governance (2018), maximum score = 100	Index of Economic Freedom (2020), dom rank of 186 countries	Bertelsmann Transformation Index: Governance (2018), maximum score = 10	Bertelsmann Governance Performance Index (2018), maximum score = 10
Countries in North Africa								
Algeria	106	22.7	2.0	111	50	169	4.6	5.1
China	80	42.8	2.0	29	..	108	4.8	5.3
Comparison countries								
Egypt	106	23.7	2.0	82	50	142	4.0	4.4
India	80	48.4	3.0	59	..	120	6.0	6.7
Libya	168	2.9	1.5	..	28	..	2.3	2.4
Malaysia	51	64.9	3.0	25	..	24	5.2	6.0
Mauritania	137	23.1	..	136	43	130	4.1	4.3
Morocco	80	41.7	2.0	45	58	78	4.3	4.7
Poland	41	72.1	3.0	60	..	46	6.3	7.7
Republic of Korea	39	77.3	2.0	26	..	25	6.5	7.9
Sudan	173	5.5	1.0	..	31	173	2.0	2.0
Sweden	4	94.7	4.0	10	..	22
Tunisia	74	44.4	2.0	73	64	128	5.3	6.0
Türkiye	91	37.9	2.0	71	..	71	4.7	5.4
United States of America	23	84.3	4.0	20	..	17
Viet Nam	96	40.9	2.0	89	..	106	4.5	5.0

Sources: Bertelsmann Stiftung, Transformation Index. Available at www.bti-project.org; Heritage Foundation, Index of Economic Freedom. Available at www.heritage.org/index; Mo Ibrahim Foundation, Ibrahim Index of African Governance. Available at <https://mo.ibrahim.foundation/our-research/iiag>; Transparency International, Corruption Perceptions Index. Available at www.transparency.org/en/cpi/2023; World Bank, World Governance Indicators database. Available at www.worldbank.org/en/publication/worldwide-governance-indicators/interactive-data-access-and-icrg-indicator-of-quality-of-government-data-set. Available at https://prosperitydata360.worldbank.org/en/indicator/QOG+BD+icrg_qog; and World Economic Forum, WEF Global Competitiveness Index: historical dataset. Available at <https://prosperitydata360.worldbank.org/en/dataset/WEF+GCIHH>.

A. Cost of distortions in North Africa

As shown in table 1, which is based on many measures of governance, the development of economies in North Africa suffers from low-quality governance. That paves the way for government failures and, as examples given in the introduction show, advantages for politically connected firms can lead to policy failures, namely, policies in which a small set of firms are favoured, which results in distorted competition and thus efficient allocation of resources.

Presented below are two assessments of the impact of distortions on labour productivity through two different measures. In the first assessment, the direct impact of distortions on total factor productivity in Morocco is examined. The second assessment contains an analysis of the impact of distortions on total factor productivity through the effect on human capital accumulation.

1. Distortions and productivity: manufacturing sector in Morocco

Morocco has improved the quality of life of its citizens in recent decades. GDP per capita multiplied by 3.1 between 1990 and 2023. However, that improvement has slowed down in recent years. For example, while GDP per capita multiplied by 2.2 between 2000 and 2010, the ratio decreased to 1.4 between 2010 and 2023. That is reflected in the growth of total factor productivity slowing steadily from 2.8 per cent in 2009 to about 1.9 per cent in 2019.

A decline also occurred in other economies in North Africa. Unemployment levels had remained at about 9 per cent from 2006 until the coronavirus disease (COVID-19) pandemic began, despite sustained economic growth. That suggests that the economy in Morocco has lost dynamism and is currently not growing enough to generate jobs. Although the economy has been going through a process of structural transformation, that process has been slower than in other emerging economies. Although labour has been slowly moving from agriculture to industry and services, the increase in output from manufacturing is not following the same pattern, hindering the economy in Morocco from creating jobs as it possibly could.

That raises additional concerns regarding the main obstacles to productivity growth in the country. Studies referred to by Hopenhayn (2014) demonstrated that the within-sector misallocation of resources is at the root of slow productivity growth. The studies are focused on quantifying the economic distortions that make some firms more productive than others and create barriers for the efficient allocation of resources. Indeed, within-sector misallocation is a result of the different levels of productivity across firms in the same sector. The greater the dispersion of productivity, the greater the potential for growth in output as a result of reduced economic distortions. The Economic Commission for Africa has reported that the dispersion of productivity among firms in North Africa is much wider compared with those in the rest of the world, suggesting that potential welfare gains from reallocation may be substantial in the subregion (United Nations, Economic Commission for Africa, 2019).

In a recent report, the High Commission for Planning of Morocco and the Economic Commission for Africa (2024) assessed the impact of distortions on total factor productivity in the manufacturing sector in Morocco. Data from surveys of manufacturing firms carried out in 2006 and 2014 (with 2,000 firms in each sample) were used to analyse the degree of total factor productivity dispersion

in the manufacturing sector in the country. The detailed firm-level data were on value added, sales, wages, employment and capital stock, as well as other general characteristics of the firms.⁴

Tables 2 and 3 show total factor productivity gains from equalizing total factor productivity across firms within each industry. The gains are reported in absolute value and relative to the total factor productivity gains in the United States of America in 1997 (see table 2). If Morocco removed allocative distortions, it would lead to substantial gains in manufacturing total factor productivity, with an increase of 106.9 per cent in 2014.

Table 2: Total factor productivity gains from removing distortions (Percentage increase)

	Chile (1996)	China (2005)	India (1994)	Japan (1981- 2008)	Morocco (2014)	Thailand (2006)	United States of America (1997)	Viet Nam (2006)
Absolute	51.2	86.6	127.5	47.2	106.9	147.8	42.9	86.8
Relative to the United States	5.8	30.5	59.2	3.0	44.8	73.4	n/a	30.7

Source: Data are from Morocco, High Commission for Planning and United Nations, Economic Commission for Africa (2024).

Relative to those in the United States, total factor productivity gains were in the order of 44.8 per cent in Morocco in 2014. The gains were in the same order of magnitude as those in comparable developing countries, such as India and Thailand, but significantly larger than those in Chile and Japan.

2. Distortions and total factor productivity in North Africa

The present section contains a quantification of the impact of firm-level distortions on total factor productivity through the misallocation of human capital, based on a study by Martinez and Benhamouche (2021). For that study, an occupational choice model was used, with firm and worker heterogeneity, extending the standard span-of-control model of Lucas (1978) in two dimensions. In the first dimension, firms demand heterogeneous inputs, and more productive firms use more complex inputs. In the second, human capital accumulation is embedded in the problem of workers. The first extension allows the relative skill demand to vary with firm-level distortions, while the second allows an endogenous response of the stock of human capital to changes in the economic environment.

In the model used for the study by Martinez and Benhamouche, more productive entrepreneurs use more complex intermediate inputs. Workers are perfect substitutes in producing those inputs, but high-skilled workers have a comparative advantage when producing more complex inputs. In equilibrium, high-skilled workers will take on tasks that correspond to their level of skill in the completion of more complex tasks. When firm-level distortions are introduced, larger firms reduce their demand relatively more compared with smaller firms.

⁴ To that end, the framework of Hsieh and Klenow (2009) was used to estimate the potential gains in output if resources in the country were reallocated to equalize marginal products to the extent observed in the United States of America.

Because larger firms are the ones that use more complex inputs, the fall in the demand for intermediate inputs is more pronounced the more complex the input is. Intuitively, without as many jobs in high-complexity intermediate goods, high-skilled workers end up allocated to fewer, less complex jobs, where they have a lower comparative advantage.

Therefore, the misallocation of talent arises from the complementarity between productive firms and high-skilled workers and the differences in the comparative advantage among workers. Furthermore, because the reduction in demand for labour is higher for high-skilled workers, the relative wage between groups (the skill premium) decreases. That reduces the incentives for all workers to accumulate human capital, but the scale that reduction is greater for high-skilled workers. In sum, lower aggregate total factor productivity is amplified by a lower stock of human capital. In addition to lower aggregate human capital, the study also found that there were two novel effects that amplified cross-country differences in total factor productivity. The first is that the endogenous reduction in human capital is higher for the most productive workers in the economy. The second is sorting: the most productive workers are allocated to less productive technologies. Those effects would be absent in a model without worker heterogeneity.

The study contains a breakdown of the effect of the lack of high-skilled workers and size-dependent distortions in North Africa,⁵ that is, economies in which aggregate human capital is low and resource misallocation is present (see the example of Morocco above). It was found that firm-level distortions are quite costly and reinforce the differences in human capital across countries. Removing the size-dependent distortions increases production per capita by roughly 2.75 times for Algeria and 4.50 times for Morocco. Part of that effect is accounted for by the endogenous response of human capital accumulation. Even though the fraction of high-skilled workers is constant in the experiment, the aggregate stock of human capital supplied to the labour market almost doubles in Algeria and almost triples in Morocco. That is evidence that firm-level distortions reduce the aggregate human capital of the economy by disincentivizing investment in skills over the life cycle. Finally, in the study, the following counterfactual experiment was performed: what would happen to the North African countries in the study if they had the same share of high-skilled workers as the United States? Although increasing the share of high-skilled workers would help, the impact would be smaller than that of reducing firm-level misallocation, and North African economies would still be far from closing the gap with the United States.⁶ The GDP per capita of the North African countries in the study would increase by about 1.75 times, but the figures for Algeria and Morocco would be about 34 per cent and 20 per cent, respectively, of the corresponding figure for the United States (see table 3).

5 The countries in the study were Egypt, Morocco and Tunisia.

6 In the literature on distortions, the United States is used as the benchmark economy, which is considered less distorted than other economies.

Table 3: Counterfactual calculations

Assumptions	Areas of inquiry	Algeria	Egypt	Morocco	Tunisia
Baseline	GDP per capita (relative to that of the United States)	0.20	0.19	0.12	0.19
	High-skilled human capital	0.16	0.15	0.10	0.17
	Low-skilled human capital	0.73	0.71	0.56	0.67
United States share of high-skilled human capital	GDP per capita (relative to that of the United States)	0.34	0.32	0.20	0.30
	High-skilled human capital	0.50	0.48	0.36	0.46
	Low-skilled human capital	0.52	0.50	0.38	0.48
No distortions	GDP per capita (relative to that of the United States)	0.55	0.55	0.54	0.60
	High-skilled human capital	0.31	0.31	0.29	0.37
	Low-skilled human capital	1.33	1.33	1.33	1.33

Notes: High- and low-skilled human capital per capita is the aggregate human capital supplied to the market. That is the sum of the human capital of all workers multiplied by the time they spend working. All the values are relative to those of the United States.

Abbreviation: GDP, gross domestic product.

The reason for that effect lies in the size-dependent distortion and the incentives to accumulate human capital. In economies suffering from distortions, such as the ones in North Africa, the impact of an educated worker is smaller because there is a lack of opportunities for those workers to be allocated to jobs in which they have a larger comparative advantage. The lower wages and opportunities imply a smaller accumulation of human capital during their lifetime, which in turn decreases aggregate output.

III. Addressing policy failures

Markets are the best places to allocate resources when they are not subject to failures. Market failures (or distortions) have many sources: market power, indivisibilities leading to economies of scale, economies of scope, sunk costs, asset specificity, imperfect information, incomplete markets, asymmetric information, externalities and positive transaction costs. Market failures prevent Pareto-efficient outcomes and lead to a role for the State in enhancing welfare. However, government interventions are also subject to failures. Both market and government failures create further distortions that result in an inefficient allocation of resources. Government failures lead to inefficient policies, or policy failures, from a collective welfare perspective. There are many ways in which government intervention can lead to policy failures.

A. Types and sources of policy failure

There are five broad categories of reasons behind policy distortions, which are described below.

1. Lack of or insufficient intervention by the State

In this case, the State does not intervene enough, or at all, to correct market failures.

2. Policy errors

Policies may not address a problem in the correct manner, which may create distortions. That can happen in many ways, for example, if there isn't sufficient State capacity or if policies are implemented poorly owing to an absence of critical information (there is a lack of an evidence base).

Policy errors can occur in all types of countries (developed or not, democratic or not), but the quality of governance may have a huge impact on policy errors.

An example of a policy error involved the import substitution strategy used in Latin America in the 1980s. It is difficult to evaluate a policy *ex ante*, and that is the reason why so much importance has been placed on experimentation in the field of economic development. Errors are often identified as such only *ex post* (when an evaluation of a public policy is conducted). What complicates the problem is that a policy can be good, which means that, theoretically, a specific problem is being properly addressed (which doesn't mean that it is the best policy), but it fails because of exogenous reasons. A policy can deliver a good outcome in a certain context but not in a different one, which poses the problem of scaling up policies.

3. Nature of policy instruments

A policy instrument can, by its nature, generate distortions. For example, taxation usually creates distortions, except when it is in the form of a lump sum.

4. Failures at the policy implementation level

An example of such a failure is when bureaucrats use discretionary power to discriminate among firms or citizens.

5. Failures at the policy decision level

An example of such a failure is when firms with political power influence regulation in their favour. Another is when excessive regulation is used for the protection of inefficient incumbents, which occurred in Tunisia under Ben Ali (see Rijkers and others, 2014).

Inefficient policies that lead to distortions can be a result of combinations of those five categories. For example, if points 2 and 3 are combined, the following could occur: (a) import licences are issued instead of exchange rate adjustment made or tariffs imposed to reduce imports, which would open room for corruption, favouritism and so forth; and (b) a discriminatory tax system is put in place to favour some economic activities or firms; or (c) subsidies are used to encourage entry into activities in which people are not productive or the most productive, but that benefit politicians (through votes).

Inefficiencies generated at the policy implementation level are potentially a huge source of distortions.

There is evidence of great variability among developing countries in terms of compliance with policies. Chong and others (2014) provide a direct measure of government efficiency through letters mailed to non-existent business addresses in 159 countries. They measured whether the

letters came back to the return address in the United States and, if they did, how long it took. They documented that about 60 per cent of the letters were returned, taking over six months, on average. Hallward-Driemeier and Pritchett (2015) compared results for indicators from the Doing Business and Enterprise Surveys. For Doing Business, what should happen given formal regulatory rules is measured, whereas, in the Enterprise Survey, what actually happens is measured. Hallward-Driemeier and Pritchett took the example of construction permits and compared the times reported in Doing Business with the median of the times reported in the Enterprise Survey in 2014 for 137 countries. The median reported time in Doing Business was 177 days, whereas the median time for the Enterprise Survey was 30 days. The higher the Doing Business score, the higher the gap between delays reported by firms in the Doing Business survey and Enterprise Survey. Those results show that policy implementation can deviate from the stated policy in firm-specific ways.

All of the types and sources of policy failure may shape the extent to which a policy creates misallocations. The table in annex II depicts different sources of policy failures, with examples and institutional factors at the root cause (the list is not exhaustive). Policy failures are mainly an issue of governance, and increasing the quality of governance is critical to reduce policy failures. However, just as there are no economies without any market failures, there are no Governments without any policy failures. There is always room for improvement in the quality of governance to reduce policy failures.

B. Reducing policy failures: recommendations

The present section contains recommendations to address policy failures. Improving the quality of governance is an overall objective in limiting policy distortions. There are many important axes of reform, notably in developing countries, to increase the quality of governance through political reforms (such as more constraints on the executive), which are beyond the scope of the present policy brief. The focus is on recommendations related to the design and implementation of policies.

1. Recommendations related to policy design

At the design stage, it is critical to avoid policies that can, through their design, create distortions (see annex I for the case of India). That means, at the minimum, limiting errors and biased influence emanating from private interests. As discussed above, there are multiple sources of policy errors, and the economic development process has “learning by doing” and “experimentation” dimensions. Errors are inherent to public policy. However, errors can be reduced by limiting their sources. Below is a list of recommendations thereon.

(a) Transparency

Transparency is crucial, as it acts as a discipline device for policymakers or bureaucrats and allows all stakeholders to receive information on the policy and use existing means to mitigate sources of policy errors. Governments should:

- a) Build a policy portal to provide information about all policies, including new ones, as well as the following information: (i) the justification for and objectives of the policy and data or evidence that supports the policy; (ii) a description of the policy, including all practical details,

and of how the policy objectives are expected to be attained for the targeted populations; (iii) related resources; and (iv) indicators of success;

- b) Publish a list of all stakeholders involved in the policy process;
- c) Inform all potential stakeholders (business associations, researchers, experts, etc.) about the policy, as communication is a central aspect of the transparency of the policy process;
- d) Publish a list of beneficiaries of the policies, including details on the supports that each firm received, if that information is available during the policy design phase (for example, some policies may target a specific sector with a limited number of firms or target specific firms).

(b) Inclusion

Inclusion is critical because it helps to build support, aggregate information, consider different interests, benefit from the expertise of stakeholders and so forth. Governments should:

- a) Define a public consultation period, in which all stakeholders can provide inputs on the policy and, to facilitate the implementation of the process, standardized forms and digital technologies could be used (digital technologies can help with more open ways of contributing (texts, documents, etc.);
- b) Include relevant stakeholders, such as business associations, but also other stakeholders (consumers, citizens, etc.).

(c) Capacity

Capacity is probably one the main factors behind policy errors, as it encompasses knowledge, skills, information and resources. A lack of capacity is a general problem in developing countries. Building policymaking capacity is a complex and vast undertaking. Governments should develop a specific training programme on policy failures to raise awareness of the matter among public servants and to establish good practices.

(d) Evaluation and monitoring

Evaluation and monitoring are crucial to be able to make the best choices and to improve “learning by doing” and policies. Governments should:

- a) Include evaluation in the design and implementation of policies, which means that the ease of evaluation should be taken into consideration in the design and implementation of a policy (for example, data should be collected on any dimension that will be required for evaluation) and, to reduce costs, a budget threshold should be set to include evaluation as a mandatory part of the policy process;
- b) Include collecting data and making them available to external stakeholders, including citizens and researchers, in the policy process;

- c) Establish a monitoring process through systematic and digitalized data collection from all stakeholders.

Limiting influence related to private interests is also of importance. That influence is certainly one of the most widespread and documented issues in countries in North Africa (see the above discussions on Egypt and Tunisia). Transparency and evaluation are important in combating that problem.

2. Recommendations related to policy implementation

Reducing the potential for creating distortions in the implementation of policies is crucial. At the implementation level, there may be arbitrary behaviour by bureaucrats, misinterpretations of the policy, errors or approximations in implementation, a lack of awareness of the policy among recipients and a lack of effort by bureaucrats to reach the targets, among other issues.

(a) Transparency

Just as for the design of policies, transparency is important for the efficient implementation of policies. Firms may not benefit from policies because they are not aware of them, or do not know if and how they can benefit, or are not targeted when they should be. Governments should:

- a) Build an implementation portal with all relevant information on the implementation of the policy, including policy content, the process to apply for or benefit from the policy, the legal framework, targeted populations, dates and duration;
- b) Publish on a regular basis a list of firms that benefited from the policy;
- c) Allow firms that should benefit from the policy but that encounter difficulties in doing so to report that information, which could be done through a policy implementation portal that is publicly accessible;
- d) Develop a digital platform for public services and policies for firms, which would help to promote transparency.

(b) Accountability and impartiality

The accountability of both policymakers and bureaucrats in charge of implementing policies is essential. Accountability in policymaking is linked to constraints on the executive, which is beyond the scope of the present policy brief and is linked to political reforms. The accountability of bureaucrats, which is linked to the internal organization of the public entity concerned, is the focus of this section. Accountability could be linked to impartiality in the implementation of policies, given that implementation is an important source of distortions. Implementation should not depend on any characteristic of a firm that is not included under the policy. Beyond creating a code of conduct for all policymakers involved in the implementation process, Governments should:

- a) Maintain a public list of firms benefiting from public support;

- b) Build an “impartiality index”, to be made public and available on a regular basis and at a sufficiently high level of granularity (ministries, public agencies, local governments and others), based on regular interviews of sampled firms, in which data are collected to evaluate the efficiency of the implementation of the policy and to capture any arbitrary behaviour from bureaucrats or the unequal treatment of firms (to ease that process, a simple smartphone application could be developed to collect data from firms);
- c) Include the impartiality index in a performance evaluation scheme for the public entity concerned, which could also be used in budgeting (a low index value should have a negative impact on the budget of the public entity, but firms should not be penalized).

(c) Anti-corruption

Bureaucrats may use their discretionary power to extract rents from firms. They may favour some firms at the expense of others, or they may deny public support to firms that, for example, do not pay a bribe. Many countries have anti-corruption agencies, but countries in North Africa are still not well ranked in terms of corruption. Policies cannot be implemented efficiently without the more effective enforcement of anti-corruption laws. It is difficult to propose any new measure, as it is political will that is necessary to achieve more control of corruption. However, the digitalization of public services and policies should be accelerated to detect any arbitrary behaviour by the public entity or, more generally, failures in the implementation of policies. All the measures proposed above can be effectively used to mitigate corruption.

Distortions could have a huge impact on the efficient use of resources in countries in North Africa, but they have not yet received appropriate attention from policymakers. In addition to addressing market failures, implementing institutional reforms to address policy failures is significant for increasing the impact of public spending and to boost economic development in the subregion.

Annex I: Policy distortions: case of India in the 1980s

In the 1980s, the economy in India had characteristics that were quite different from those of similar Asian economies. In addition to having a service sector that was more important than its manufacturing sector, the country had a manufacturing sector that was more skills intensive than labour intensive, and the average size of firms within industries was small.

Those patterns of the economy in India were the result of the distortions created by public policies. The strategy of the Government of India included objectives that led to the following policy choices: (a) using an import substitution strategy; (b) having massive public investment in production and barriers to private investment in order to control the development of the private sector; and (c) ensuring that development was geographical balanced.

There were negative consequences for the allocation of resources as a result of policies on the following:

- a) Benefits to small-scale firms, including tax concessions, preferential access to credit, interest rate subsidies, preferential treatment in procurement and restricted market access for large-scale firms;
- b) Stringent labour regulations for large-scale firms: in 1976, firms employing more than 300 persons required administrative authorization to fire workers; in 1982, the ceiling was lowered to 100 employees;
- c) Industrial licensing for production, investment and imports, with credit and foreign exchange controls;
- d) Enactment of the Monopolies and Restrictive Trade Practices Act to impose constraints on the growth of large firms;
- e) Orientation of investment towards areas in which productivity was not the highest.

Those policies led to a concentration of manufacturing in large-scale industries and to firms operating on a smaller scale than in other countries. Although labour abundant and poor in capital, the economy in India ended up using too little labour and using capital inefficiently. That may have prevented the country from reallocating labour from agriculture to manufacturing as quickly as other countries did in, for example, East Asia.

Annex II: Source of policy distortions

Sources of distortions	Specific manifestations	Can it lead to distortions?	Examples of distortions created	Examples of institutional factors
Lack of or insufficient intervention by the State	Insufficient regulation	Yes	Monopoly power	Regulatory quality
	Insufficient intervention to correct market failures	Yes	Credit market failures	State capacity: lack of knowledge, skills and information
	Insufficient public goods, such as provisions for schools	Yes	Regulations through which some firms receive an advantage	State capacity: resources
	Poor quality of services	Yes	Some firms may be able to benefit more than others from public services	State capacity: resources, skills, knowledge and data
Policy errors	Lack of information or data	Yes	Some firms may be better able to defend their interests	State capacity: transparency and resources
	Information asymmetry			
Types of instruments	Lack of skills or knowledge	Yes	Lack of skills can lead to the influence of firms on policies	State capacity
	Lack of resources	Yes	This may lead to some firms receiving support and others not	State capacity
	Taxes	Yes	Corporate income tax with complex provisions; loopholes and opportunities for evasion and arbitrage can be generated	State capacity: tax system (corruption in tax administration)
	Tariffs	Yes	Taxes that depend on size, sector or age (see the annex for the example of India)	Regulatory capacity
	Subsidies	Yes	Discriminatory application of tariffs	
	Licences	Yes	Discriminatory allocation of subsidies Licences through which entry is limited and inefficient incumbents are protected	
			Licences through which doors for bureaucratic discretion are opened	
			Norms through which some activities or firms are penalized	
			Norms that are not binding for all firms	

Sources of distortions	Specific manifestations	Can it lead to distortions?	Examples of distortions created	Examples of institutional factors
Policy decision level	Lack of coordination	Yes	A lack of coordination on policies may result in firms being targeted differently or selectively	Government effectiveness and political factors
	Some firms left out of consultation process	Yes	Full information may not be considered in policies Issues faced by diverse types of firms may not be integrated in policies	Government effectiveness and political factors (incumbent firms or private interest groups may have influence over policies)
	Lobbies and other interest groups	Yes	Influence over regulations	Accountability, government effectiveness and political factors (incumbent firms or private interest groups may have influence over policies)
	Selective policies (targeting different groups of firms) in many dimensions, including product, geography, size or ethnicity	Yes	Regulations affecting the hiring and firing of workers apply only to firms above a certain threshold in a number of countries (for example, India in the 1980s)	Accountability, government effectiveness, political factors (incumbent firms or private interest groups may have influence over policies)
	Bureaucratic procedures	Yes	Heavy bureaucratic procedures can be used as discriminatory tools by bureaucrats to favour some firms	Accountability, government effectiveness, political factors (incumbent firms or private interest groups may have influence over policies)
Policy implementation level	Discretionary power of bureaucrats	Yes	Bureaucrats may favour some firms over others	Accountability and other political factors, corruption and freedom of the press
	Power of firms to influence bureaucrats	Yes	Influence over policy process	Accountability, government effectiveness, political factors, corruption and freedom of the press

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