A Reexamination of the Political Economy of Growth in MENA Countries

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Abstract

Since the 1980s, economic growth in Middle East and North African (MENA) region has been low and volatile. The problem has been attributed to bad economic policies, such as excessive government interventions, large public sectors, restrictive trade policies, inefficient mass subsidies, and badly managed fiscal policies. This paper examines the political economy factors that have shaped those policies and their outcomes. It offers a framework based on the recent political economy literature to explore the deeper forces behind the puzzles of growth variations in the region, going beyond the claims that powerful interest groups have been blocking reform. It focuses on the reasons why interest groups and politicians may not have been able to adopt better policies and generate larger surpluses for them to reap. The usefulness of the framework is illustrated by applications to key political economy issues in MENA. The paper examines the mechanisms through which resource rents have affected government policies and economic growth in the region and agues that the impact has varied depending on other factors. The analysis includes the roles of authoritarianism, social heterogeneity, geopolitical rents and threats, human capital, and administrative and judicial institutions. It shows how resource rents and other factors have shaped government interventions and growth in before 1980s and how they made adjustment and growth costly later on to varying degrees.

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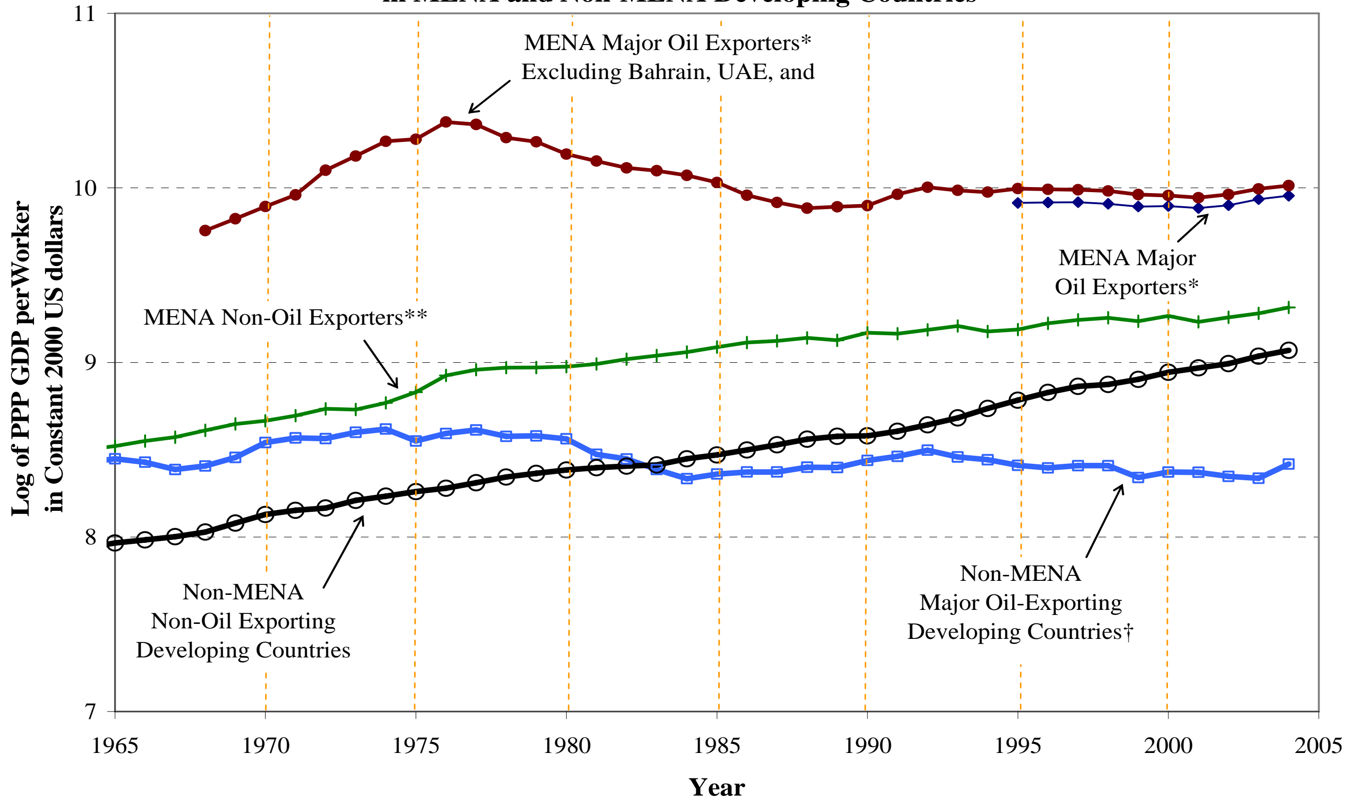
1. Introduction

Over the past two decades, economic growth in Middle East and North African (MENA) countries has been generally low and relatively volatile (see Figures 1 and Table 1). This has been the case compared to the rest of the developing world as well as MENA's own prior experience. A widely-held view among the economists studying the region links the problem to bad economic policies adopted by MENA governments. The view suggests that those policies can typically be characterized by extensive government intervention, large public sectors, restrictive trade policies, inefficient mass subsidies (especially for energy and food), and precarious fiscal conditions (Henry and Springborg, 2001; Sala-i-Martín and Artadi. 2003; Abed and Davoodi, 2003; Yousef, 2004). However, if such policies can indeed be held responsible for low growth, one has to wonder why many governments have opted for them. And, to the extent that actual policies have been different from this description, there is still a question why those policies were selected and why they did not work in many cases.

A number of political economy studies of MENA countries have sought to answer the above question by searching for politically organized groups that find growth-enhancing policies inimical to their interests and, thus, try to block the adoption of such policies (see, e.g., Sadowski, 1991; Richards, 1991; Waterbury. 1993; Henry and Springborg, 2001). However, the answers proposed in those studies are often incomplete because they do not explain why in the slow growing countries the interest groups and politicians cannot find ways to adopt better policies that generate larger surpluses for them to reap.

Another popular explanation of bad policies and growth failures is based on the so-called "natural resource curse" hypothesis. The argument is that large oil rents can induce a voracious rent-seeking that erodes institutional development through effects such as massive corruption, patronage, etc. (Leite and Weidmann. 1999). This effect is believed to undermine growth because it hampers the government's ability to implement efficient policies. The problem is further compounded by the oil-rich countries' need to manage the revenue volatility and the real exchange appreciation that oil rents entail (Makdisi, Fattah, and Limam, 2005; Ersel and Kandil, 2005). While these effects have often been detected empirically in the data, their theoretical foundations have not been clear. In particular, when one observes countries such as Norway manage their oil rents well without institutional deterioration, it becomes clear that there is a need to explore the conditions under which the explanation applies (Sala-i-Martin and Subramanian, 2003).

Figure 1
Weighted Average PPP GDP per Worker
in MENA and Non-MENA Developing Countries



Note: The weights for averaging are countries' PPP GDP.

* Algeria, Bahrain, Iran, Kuwait, Oman, Saudi Arabia, United Arab Emirates, and Yemen.

** Egypt, Jordan, Morocco, Sudan, Syria, Tunisia, and Turkey. Other countries are excluded due to lack of sufficient data. There is data for Lebanon after 1988, but adding it to the chart does not change the picture much for those years.

† Angola, Republic of Congo, Gabon, Nigeria, Trinidad and Tobago, and Venezuela.

Source: Calculated based on World Bank's *World Development Indicators*.

A third interpretation of MENA's growth pattern combines the interest group and resource curse explanations into a more structured perspective. This approach argues that the rising natural resource rents before 1980 allowed high investment and high growth while strengthening redistributive policies in the form of implicit "social contracts" between the rulers, the public, and various interest groups in MENA societies. Later, those social contracts came to haunt MENA economies when resource rents declined. The reason was that the region's politicians were still expected to deliver on their distributive promises in exchange for public acquiescence to their rule. This may have severely constrained the room for the re-orientation of policies towards higher efficiency and growth (Yousef, 2004). However, this view still leaves the details regarding the nature of social contracts and the sources of their variation across countries and over time unspecified. This is important because the view does not show why

MENA polities did not continue to demand growth in the past quarter century and often settled with inefficient redistributive deals. Even if the initial contracts had a redistributive character, one wonders why their bases did not shift towards growth, especially when resource rents diminished. This is particularly puzzling because social contracts were also common among East Asian countries, which succeeded with little natural resources by emphasizing shared growth rather than pure redistribution (Campos and Root, 1996).

Table 1

Per Worker GDP Growth and Volatility in MENA Countries

Country*	Average Per Worker GDP Growth Rate Period:					Standard Deviation for the years available
	1955-1964	1965-1974	1975-1984	1985-1994	1995-2004	
Oil Exporting						
Algeria	1.52	4.71	2.20	–3.16	0.00	8.51
Bahrain	n.a.	n.a.	–6.30	1.01	1.36	6.67
Iran	6.95	9.87	–1.66	–0.26	0.89	7.50
Kuwait	n.a.	–4.17	–8.81	–1.12	–2.95	10.57
Oman	4.30	16.83	4.48	1.72	0.44	16.27
Saudi Arabia	n.a.	13.52	–4.37	–0.32	–0.41	8.69
United Arab Emir.	n.a.	–6.64	–4.66	–4.58	–0.39	8.60
Yemen	n.a.	n.a.	n.a.	1.90	1.80	4.46
Non-Oil Exporting						
Egypt	3.42	1.35	6.49	0.78	1.42	3.56
Jordan	6.86	–0.62	8.24	–3.13	–0.72	8.99
Lebanon	n.a.	n.a.	n.a.	8.08	0.59	18.55
Morocco	0.67	2.58	1.95	1.60	0.36	4.43
Sudan	–1.28	–0.11	1.28	1.80	2.90	5.71
Syria	6.78	4.44	3.01	1.35	0.26	8.01
Tunisia	6.05	4.07	1.94	1.14	1.87	3.52
Turkey	4.69	3.74	2.17	1.53	1.86	4.74
Non-MNA Oil Exporters**	**5.32**	**1.94**	**-2.84**	**1.08**	**0.08**	**6.79**
Non-MNA Non-Oil Exporters**	**4.43**	**2.98**	**2.14**	**2.89**	**3.18**	**4.61**

n.a. Not available.

* Djibouti, Iraq, Libya, Oman, Qatar, and West Bank and Gaza are not included due to lack of sufficient data.

** Weighted averages, with each country's PPP GDP serving as its weight. Oil exporters consist of Angola, Republic of Congo, Gabon, Nigeria, Trinidad and Tobago, and Venezuela.

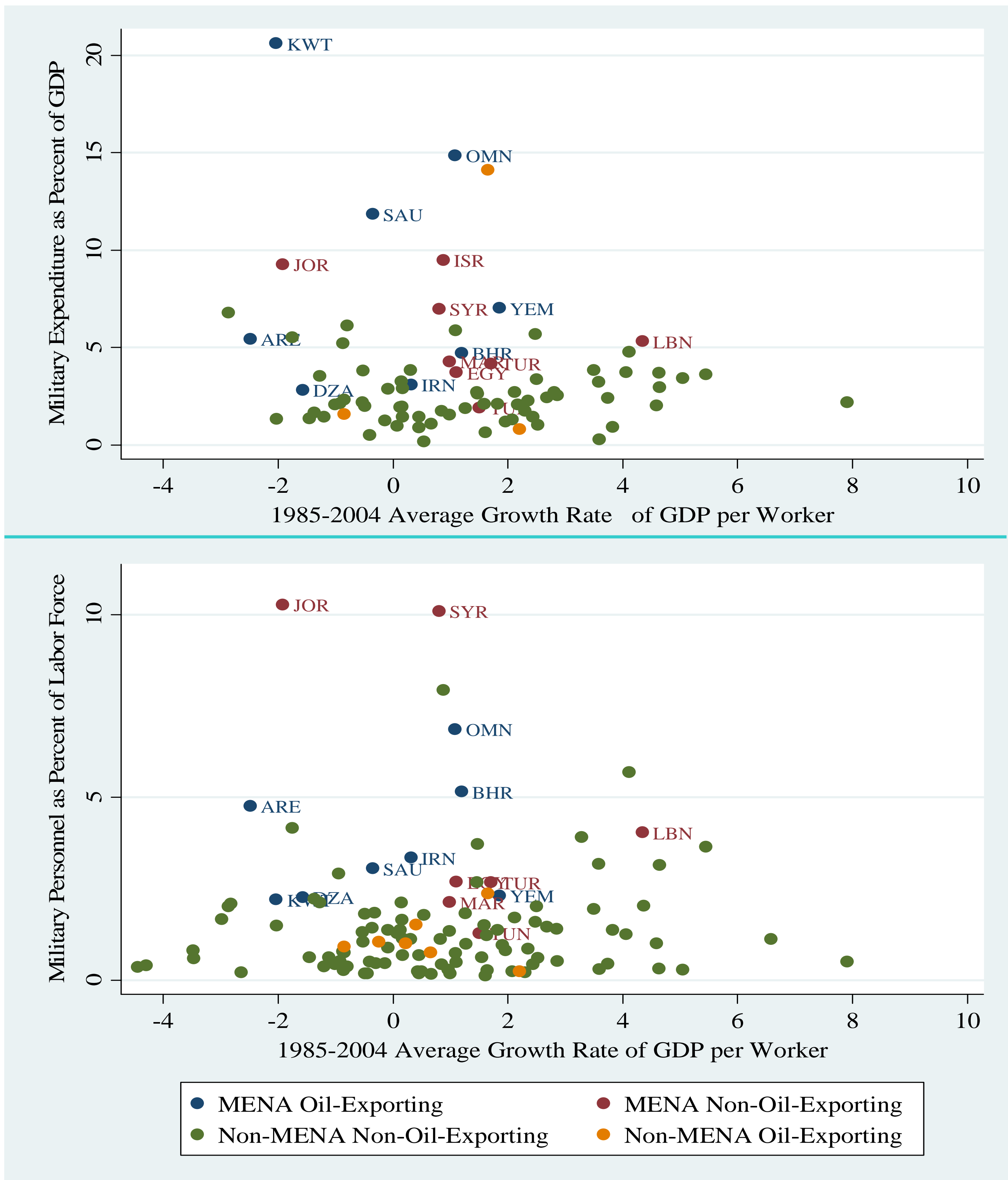
Source: Calculated based on World Bank's *World Development Indicators*.

Another factor often mentioned as a cause of slow economic growth in MENA is the large amounts of labor and public funds devoted to military (UNDP, 2002; Lebovic and Ishaq, 1987; Abu-Bader and Abu-Qarn, 2003). Indeed, as Figure 2 shows, MENA countries stand out among developing countries in terms the military's share in employment and GDP. This is often attributed to the presence of domestic and international conflicts, especially the Arab-Israeli confrontations. Such conflicts and their associated military expenditures are believed to have contributed to economic risks and shortage of funds in the region, thus reducing the incentives and the ability to invest and enhance productivity. They may have also hindered the institutional developments needed for improved policymaking and economic performance. However, some have argued that given the presence of conflicts, military expenditure may have played a positive role by bringing about stability and order (see especially the recent panel data analysis by Yildirim et al., 2005). Again, it is clear that there is a need to further explore the political economy factors that give rise to conflicts in MENA region and shape their impacts on economic growth.

This paper proposes a framework based on the recent political economy literature that offers ways of finding deeper answers for the puzzles of growth variation and slowdown in MENA region. The approach presented here is part of a growing number of perspectives on the political economy of growth that seek to explain differences in growth-related policies and institutions across countries. Recent examples of such work that also provide surveys of the literature are Castanheira and Esfahani (2003), Acemoglu, Johnson, and Robinson (2005), and Rodrik (2003 and 2005). Of course, the political economy literature is vast and the references given here are meant to be representative rather than exhaustive. The present paper refines the existing studies by integrating their findings around a key theme—namely, *incomplete contracting*—and by incorporating additional effects implied by that theme into the framework. The value of the framework is highlighted by applying it to some of the major growth issues of MENA countries. The purpose of this application is not to find a definitive explanation for MENA's growth puzzle. Rather, the aim is to suggest that the proposed political economy framework is a promising approach for further case-study and cross-country research on the subject. Some results of such case studies are synthesized in Esfahani (2006).

Section 2 below discusses the analytical framework. Section 3 examines a number of policies and institutions in MENA countries to show how the framework can shed light on the forces that may cause inefficiency in the interactions among the politicians, interest groups, and the public. Section 4 concludes.

Figure 2
Military Expenditure, Military Personnel, and GDP Growth in Developing Countries
1985-2004 Averages



Source: World Bank, World Development Indicators.

2. A Framework for Analyzing the Political Economy of Growth

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

To keep things simple, I identify three main categories of agents in the political economy systems: *the public* (or the population at large who act as *voters* when there are elections or other opportunities to show public approval or disapproval of policies or policymakers), *interest groups* (organized groups that influence policy decisions on a systematic basis but do not control it directly) and *political elites* (or, for short, *politicians*: elected or self-proclaimed policymakers, administrators, and political parties).[1] Politicians are interested in expanding their control over the government apparatus, which requires public and/or interest group support. Each member of the public and each *interest group* wants to maximize its net benefits from the economy and can offer its support to politicians in exchange for receiving the benefits induced by policy. This implies that in choosing economic policies, politicians are largely motivated by the relative ability of interest groups and various segments of voters to support them. Struggles to capture a larger share of the economic surplus can arise both *within* and *across* interest groups and voter segments, and the eventual allocation is determined by the rules of the political game.

The main premise of the approach developed here is that *contracting problems are the key impediments to economic growth*. The argument is that it is the *incompleteness of contracts*, rather than the presence of social contracts, that has hindered MENA's growth. Contracting problems include asymmetric information and moral hazard as well as the difficulties and costs of writing complete contracts due to complexities in foreseeing and specifying all possible contingencies in dynamic human

[1] One can further subdivide these categories in order to account for the relative powers or the ranks of the officials (e.g. ministers vs. civil servants, the dominant party vs. the others) or the real power of different interest groups (e.g. unions vs. the army or other groups present in the country). Those divisions will be discussed below where needed. The main categories highlighted here capture the *functional* differences in their access to power: voters have power at election times, and much less power when elections are away. Instead, interest groups can maintain their influence (sometimes by monetary means, sometimes by demonstrations and strikes) on a more regular basis. Political elites, on their side, directly control the policy levers, favoring one or another group.

transactions. As is well-known from the Coase Theorem, in the absence of contracting problems, members of a society should be able to motivate each other and remove all inefficiencies in investment and production. This should render the largest social surplus that is technologically possible, and especially provide opportunities for rapid growth and catch-up when the country is not already at the production possibility frontier. Thus, when growth remains low in a developing country, there must be contracting problems that prevent the realization or proper allocation of the maximum surplus. The claim is that the more serious the contracting problems are, the lower the growth rate is likely to be.

The extent of contracting problems in a country depends on the characteristics of its *resources*, *politics*, and *institutions*. Here I define these concepts and discuss their relevant characteristics.

2.1. Resources

The available resources—including natural and human resources, physical capital and technology—matter because they shape the possibilities for production and the nature of contracting and incentives required to reach efficiency. In political economy studies, the nature of available resources normally receives attention only when natural resources play a major role in the economy. This aspect, of course, is particularly important for MENA countries that are endowed with oil as well as the others that are indirectly affected through their exchanges with oil-exporting countries (e.g., via foreign aid, capital flows, and labor migration). However, this often overshadows the fact that human resources are also important because they help bring together other resources and make them productive by applying technology. Moreover, human capital can facilitate the identification of growth problems and the design and implementation of effective solutions for them. Most MENA countries face shortages of human capital in a variety of areas. Although there have been major efforts to expand education in the region, the achievements have been uneven partly because the policy circles themselves are often short of the expertise necessary to design and implement productive policies.

The key resource characteristics that need to be recognized and examined for understanding growth are those that determine how much rent and quasi-rent can be generated by the available resources, how elastic their supplies are, and how difficult it is to contract over the process by which they become available for production. For example, natural resources tend to have inelastic supplies and often generate large surpluses relative to costs of production, but the degree of contracting difficulty varies across different types of resources. For example, forests can be quickly cut, but oil requires long-term investment in exploration and extraction (Deacan and Bohn, 2000). The supply of human capital, on the other hand, may be relatively more elastic and contracting over its delivery often faces major imperfections, especially in activities that require creativity and innovation (Hart, et al., 1997). For

physical capital, the supply is often elastic and contracting problems exist *ex ante*, but those elements diminish *ex post* once capital is in place.

2.2. Politics

Politics shapes the nature of group conflicts that need to be resolved in the collective action process. The diversity of preferences and fragmentation of the society (e.g., differences in language, religion, ethnicity, resource endowments, etc. that lead to cleavages among groups) raise the likelihood of difficulties in making deals both at the micro and macro levels. A more contentious set of interest groups may exert greater effort to keep each other at bay and, as a result, may raise bigger obstacles for the adoption of collectively beneficial policies by the government. In particular, such demands can obstruct appropriate regulations (or give rise to excessive and inappropriate regulations) in the economy and, thus, result in significant inefficiency and slow growth (Alesina and Drazen, 1991; Alesina et al., 2003). On the other hand, when there is harmony of interests or when the dominant groups have sufficiently encompassing interests, selected policies are more likely to be efficient (McGuire and Oslon, 1996).

It should be noted that although the boundaries of interest groups and the extent of their heterogeneity may be given in the short and medium runs, they do not necessarily remain fixed factors over decades, even when groups are formed based on language, religion, or ethnicity. In fact, many interest groups form around organizations, where the members develop common interests and specific capital associated with their organizations, as in industry-specific lobbies, the government bureaucracies, or the military. The dynamics of such groups and their interactions can be quite rich and complex, particularly because they strive to influence government policies and expenditures that may in turn affect their own position and strength (see Acemoglu and Robinson, 2001, and references therein).

Analyzing the role of heterogeneity in political and economic performance raises a number of key issues: which dimensions of diversity matter, in which ways, and how those dimensions must be measured. Until recently, the common practice was to use Herfindahl indices of fractionalization for ethnic, linguistic, and religious aspects of heterogeneity, which are more observable and stable over time (see Alesina et al., 2003). This index is often found to be negatively and significantly related to GDP growth. However, it does not appear to be well correlated with most aspects of social and political conflict that are often claimed to be the links between fractionalization and growth. For this reason, to shed light on the underlying connections between heterogeneity and political economy outcomes, a number of studies have offered new measures that focus on other aspects of heterogeneity. In particular, the polarization indices developed by Esteban and Ray (1994) and Montalvo and Reynal-Querol (2005) try to capture the fact that when fractionalization is very high, in a way the society may look relatively homogenous since the differences among groups may become smaller or their conflicts may be more

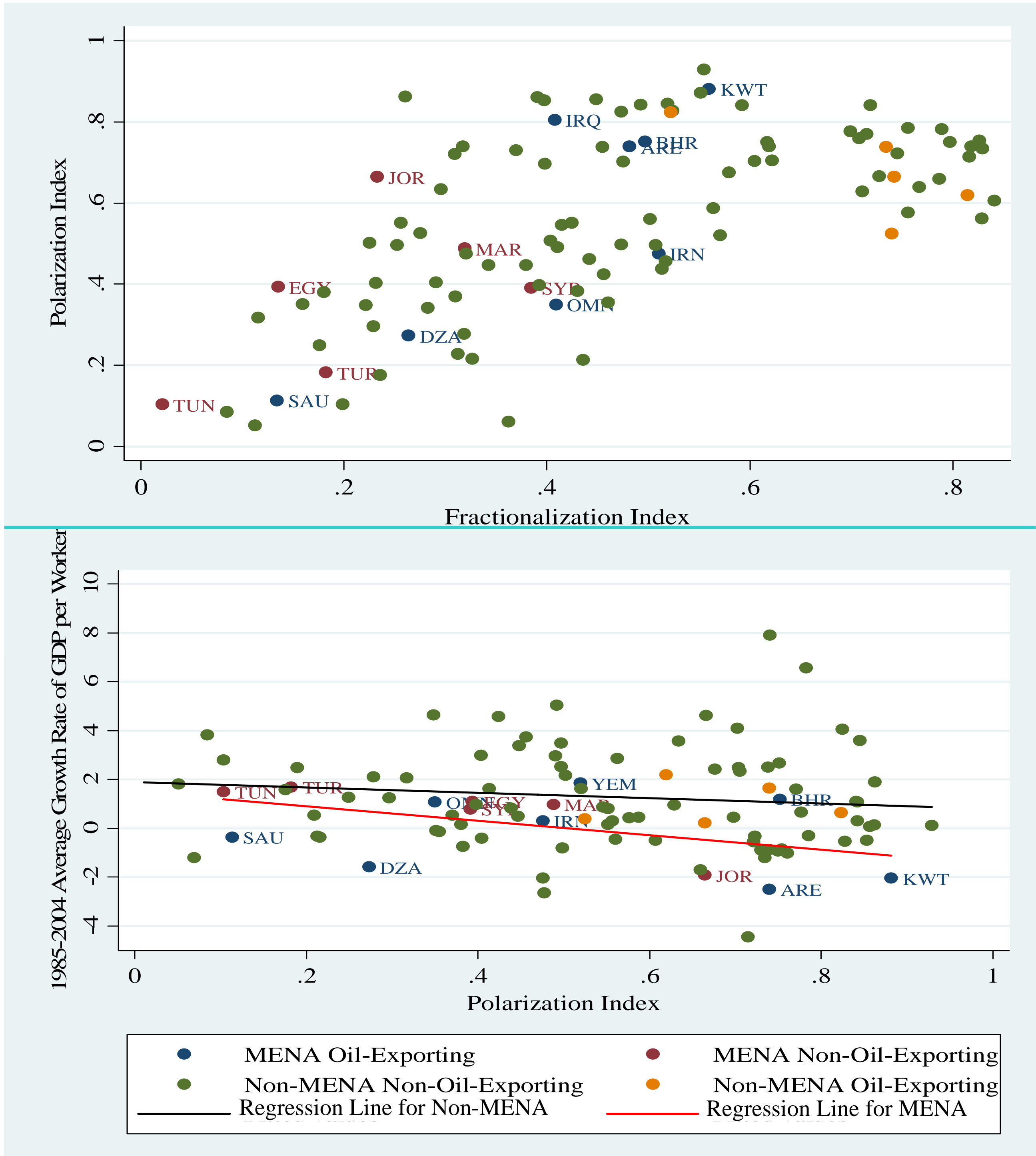
localized and less consequential for the system as a whole. (It should be pointed out that these polarization indices focus on the probability inter-group alienation and within group identity, not the actual intensity of differences and loyalties.) Montalvo and Reynal-Querol (2005) show that their index explains within-society conflict much better than fractionalization, though it is not well correlated with cross-country growth. The upper panel of Figure 3 compares two indices for fractionalization and polarization for 134 countries and highlights the non-linear relationship between the two.

Heterogeneity factors are not confined to ethno-linguistic and religious polarization. Other notable sources of diversity are ideological and cultural orientation (e.g., modernist vs. traditional), asset ownership, location (region, urban vs. rural), industry, and organizational affiliation (e.g., the military or political parties and cliques). Each of these factors, which are at least partially endogenous, may have rich interactions with other elements of heterogeneity. For example, political parties may add fuel to the fire of inter-group rivalry or may help enhance national identity and, thereby, reduce ethno-linguistic and religious alienation, class conflict, etc. Naturally, the way that the economy's resources are applied and the institutional mechanisms needed to achieve good performance are different in those varying political conditions.

In MENA region, the extent of preference diversity and potential conflicts vary greatly. However, by the fractionalization measure of ethno-linguistic and religious diversity, MENA countries generally don't rank very high. So, to the extent that this factor matters for growth, they should fare well. But, by the polarization index, parts of MENA region lie in the upper half of the sample, and even that may understate the actual inter-group tensions some countries where societies are divided into contending groups with distinct fault lines, as in Algeria, Iraq, and Lebanon.

Concentration of land and capital ownership has also served as a source of conflict, resulting in many confiscation and redistribution episodes by national leaders who sought to broaden their public support or dispossess their political rivals, or both. The cases in point are the land reforms and nationalizations in Egypt during 1952-1963, in Iraq, Syria, and Tunisia in the late 1950s, in Algeria after independence in 1962 and again in the early 1970s, and in Iran in 1963 and again after the 1979 Revolution.

Figure 3
Fractionalization, Polarization, and GDP Growth in Developing Countries*



* Fractional index is the average of ethnic, linguistic, and religious Herfindahl indices for the three dimensions of heterogeneity. Polarization index is the average of polarity of ethnic and religious distributions according to the measure proposed by Montalvo and Reynal-Querol (2005). Averaging is done as a rough aggregation method to saving space. Similar relations emerge when individual components are used.

Source: Alesina et al. (2003), Montalvo and Reynal-Querol (2005), and *World Development Indicators*.

Of course, the intensity and role of group interactions depend on prevailing ideologies at the group and national levels. In particular, as North (2005) points out, nationalist ideologies can play important roles in mitigating potential conflicts arising from polarization. In MENA, at many points in time, political leaders have managed to use nationalist ideologies to overcome or suppress major internal conflicts and, thereby, facilitate mobilization of economic resources. These efforts seem to have been most successful in situations when new regimes have come to power following long wars or crises, where the need for establishing order has provided potent arguments and drives for muffling internal conflicts, at least for a while. Although order in these cases has typically come about through dictatorship, sometimes they have been able to strengthen national identities and to dilute religious or ethnic conflicts on a long term basis (e.g., Turkey under Ataturk and Iran under Reza Shah). In the case of Arab countries, similar ideological tools have also used for forming cross-country movements. However, these movements have rarely gained strength (with the exceptions of Baath and Nasserist movements) and even when they have gained some force they have intensified conflict at other fault lines and have ultimately disintegrated.

2.3. Institutions

Institutions are the rules that assign roles to individuals in the society and structure their interactions. These rules range from informal cultural norms to formal legal and political procedures governing the country. The allocation of decision-making powers and the constraints that institutions place on individual behavior can help or hinder the potential for resolving conflicts and reaching efficient and enforceable deals. Institutions have many aspects and dimensions. To make the analysis manageable, I focus on governance institutions because they play fundamental roles in alleviating or exacerbating deficiencies in other rules. Furthermore, I concentrate on institutional aspects that affect *representation*, *commitment*, and *coordination* in the interactions of various groups through the government. These three dimensions of governance institutions are crucial for the extent to which the government can overcome contracting problems and help various groups strike efficient deals that take the economy closer to its production possibility frontier. The following discussion expounds this point.

Representation

For efficient collective decision-making in a heterogeneous society, various segments of the population must be somehow represented in the government; otherwise important information about the preferences of some groups may not be incorporated in government decisions. This can lead to distortions in the production incentives, both among those groups as well as others that interact with them. For example, when the government ignores the educational needs of one part of the population, they may be discouraged from engaging in productive activities and may become foot soldiers in rivalries among more powerful groups. Representation can be viewed as the set of political or social institutions that enable

various groups to conclude effective contracts with the politicians, offering support or acquiescence to political power in exchange for policies that address those groups' concerns. Effectiveness of such institutions depends on the capability of various parts of the population to ensure that their demands are given due consideration and weight by the policymakers. In the economic growth literature, representation is often identified with electoral democracy, which does not seem to have a direct relationship with growth (Barro, 1996; Acemoglu et al., 2005b). Although democracy certainly enhances representation, it also entails many other institutional aspects with additional multifaceted effects, as we will see below. Besides, having a chance to vote for politicians is only one, often imperfect, mechanism for the population to influence policymakers. In fact, in addition to the opportunity to react to policy outcomes, thorough representation requires channels that connect the public to the process of policymaking through political, professional, and social organizations. These latter channels—whether trade unions, business associations, religious organizations, or tribal structures—may also exist and provide some representation even in the absence of elections and other formal democratic institutions.

In MENA countries, representation mechanisms are often believed to be weak. This is particularly an issue in the region's larger, more diversified countries that lack democratic institutions. There also seems to be differences in representation across monarchies and republics in the region. In monarchies, the rulers depend more on traditional and family relations to connect with broader segments of the population. In contrast, in countries where republics have been established through military coups, revolutions, or national liberation movements, pre-existing power relations have crumbled and the political elite have had to rely more on new forms of political and administrative organization to manage their relations with the population at large (Owen, 2004). However, since these organizations have been initiated from above, they have typically served more as means of political control by the elite rather than representation (Ayubi, 1995).

Commitment

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

enforceable contracts (North and Weingast, 1989). However, a dictator with a secure, long-term position may also be able to offer some commitment to efficient policies based on his incentive to maintain a reputation for future dealings.

In recent years, most of the research on the role of institutions in economic growth has focused on the commitment issue—often under the rubrics of property rights security and constraints on governments—as the key determinant of long-run income levels. (See, in particular, the large volume of work spun by Acemoglu and his associates; e.g., Acemoglu and Robinson, 2005, and Acemoglu et al., 2001, 2005a, and 2005b. See also Rodrik, et al., 2002, among others.) As in the case of representation, some authors associate commitment capability with democratic rule. However, the more recent contributions to this literature show that in underdeveloped economies, limitations on democracy may enable the elite to protect their investments against the taxation power of the poor majority, thus ensuring the incentives needed to initiate investment and growth (Acemoglu, 2005). Of course, once the economy develops to some extent, further growth is likely to require transition to democracy.

Commitment through non-democratic mechanisms (reputation of the autocrat and rent sharing with the elite) has been prevalent among MENA countries, though it has not always worked well, especially in the cases of detailed policies matters. Examples of such cases will be discussed in section 3.

Coordination

Coordination is another crucial institutional feature needed for minimizing resource waste because distributive struggles typically create a "tragedy of the commons" problem where the parties involved tend to overexploit the rent source over which they compete or overuse their own resource to secure a larger share (Persson and Svensson, 1989; Alesina and Tabellini, 1990). For example, when government budgets are made in parliaments where the lawmakers can independently and freely propose amendments, total expenditure and the deficit tend to be inefficiently large (von Hagen, 1992; Alesina and Perotti, 1995; Velasco, 1999). The reason is that in such a situation, the cost of an additional dollar spent on the favorite project of each policymaker is shared by the population at large and, as a result, is not fully internalized. Similar problems exist in trade policy formation and many other public policies. Coordination across policy areas (e.g., coordinating trade, labor, and fiscal policies) tends to pose even harder problems and could be the source of major inefficiency in the economy if the country lacks appropriate institutional mechanisms. Of course, coordination would not arise as a problem to the extent that decision-making on public policy could be decentralized without external effects—e.g., in a market-like fashion. However, this is not possible in many areas of public policy; hence the need for other institutional mechanisms to bring about coordination. One mechanism is *ex ante* constraints (e.g., balanced-budget laws) that force everyone to act within limits, though such constraints are typically too inflexible and inefficient because specifying *ex ante* rules that anticipate all possible future situations is

very rarely practical. A more flexible mechanism is "delegation," where one or a few individuals make the aggregate decisions that bring everyone into line. This obviously implies some centralization and, to be effective, requires proper incentives for those in charge of the aggregate decisions. An intermediate mechanism is *ex ante* limits that are renegotiated on a regular basis and only delegate the task of enforcing the agreed limits. Of course, the effectiveness of all these arrangements varies depends on the nature of other political institutions, such as political parties. For example, coordination is much easier when a few parties are in a position to aggregate the population's interests in a decentralized way and negotiate them with each other.

In MENA countries, high degrees of power concentration have often facilitated coordination over major policies. But, those institutional arrangements have not been suitable for more detailed actions of government agencies because processing the details of minor policy matters quickly becomes overwhelming for the center. More on this will come below.

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

However, there are some tradeoffs among the three institutional dimensions as well, especially between representation and coordination. Better representation can make coordination more difficult because it requires the decision-making process to take account of more political demands. Conversely, coordination mechanisms may constrain the possibilities for broad representation. Of course, such tradeoffs and complementarities vary across countries depending on their economic and institutional conditions. For example, in a country facing chaos, establishing some mechanism for coordination is likely to be crucial and sacrificing it to ensure better representation may come at a huge cost in terms of economic growth. On the other hand, when the basic coordination problems have been solved, weak representation can become a key source of instability and inefficiency. Another example is the increased value of commitment capability when the government does not have access to cheap resource rents and

cannot create employment and promote growth through subsidized private investment or public investment (Esfahani and Toossi-Ardakani, 2002). Some countries (e.g., those with less political polarization and better rule of law tradition) are able to resolve the tension among the institutional functions relatively well and reach high levels of capability in all dimensions. In other countries, long-term growth performance is constrained by the fact that some institutional capabilities are missing and trying to build them comes at a high cost in terms of other capabilities (e.g., forcing coordination at the cost of representation or vice versa).

2.4. Dynamics in the Political Economy of Growth

The above discussion offers a framework for understanding what the growth potentials of a country are at a point in time given its resources, politics, and institutions. However, the latter factors are by no means static or exogenous. Changes in demographics and resource characteristics, partly as a result of the growth process itself, influence the relative powers and interests of various groups, which lead to changes in politics. Those forces in turn may make the existing institutions obsolete and prompt interest groups to seek changes in rules. In analyzing this process, it is important to note that the existing power structure at each time has important implications for the set of likely institutions that emerge subsequently. As Acemoglu, Johnson, and Robinson (2005) have emphasized, the desire of dominant groups to maintain their powers plays an important role in enhancing or hindering institutional change. Of course, that effect should be weighed against the shifts in potential balance of power brought about by developments in resources. Also, there are important institutional and political changes that come about not through the desire of politically active groups, but rather as byproducts of unintended socio-economic developments. For example, the turn to religion as a political tool in recent decades could not have happened without deep socio-economic developments that made such a trend feasible, in some instances in clear opposition to the desire of the ruling elite.

Another important issue in the analysis of growth dynamics is that institutions are by definition costly to change. Indeed, rules that are easy to change cannot become institutions that constrain the behavior of actors in an economy. In other words, the institutions that matter must be rules that are difficult to change either because they are self-enforcing or because they are supported by other institutions that require substantial effort and coordination to change. A key implication of this observation is that institutional change comes about only when shifts in resources and politics have raised the cost-benefit ratio of the status quo for a sufficiently large group of actors.

A further consideration in growth dynamics is the fact that the onset of economic growth does not require deep and extensive institutional reform, as Rodrik (2005) and Glaeser et al. (2004) have noted. In many instances, small and limited policy changes have been observed to initiate remarkable growth

episodes. One crucial factor that may have been at work in such cases is innovation in business-government and intra-government relations in ways that made contracting among them more complete via performance indicators that were more easily observable to both businesses and policymakers. For example, a key reason for the success of export promotion policies of Korea and Taiwan in the 1960s and 1970s may have been the use of *net foreign exchange earnings* as an indicator of performance. Those policies offered rewards to domestic entrepreneurs based on a criterion that was far more observable than the deals given under import substitution policies (which at least in theory were based on their contribution to production capacity and *foreign exchange savings*). Although both types of policy offered rents to domestic producers and could help mitigate their investment constraints (especially finance and foreign exchange problems) relative to their foreign competitors, export promotion policies proved more successful because they offered more complete "policy contracts." The latter policies were also more effective in enabling the entrepreneurs search for their sources of comparative advantage and break into international markets. Of course, this was not possible in all industries because not all industries could be expected to become exporters and, besides, government subsidy funds were limited. As a result, policymakers maintained import restrictions for quite some time on a wide range of products in order to protect many industries and collect public funds for subsidizing the rest. Interestingly, the innovation in trade policies seems to have helped address some governance problems as well. By observing export performance and collecting feedback from exporters on their experiences with public services, policymakers could assess the performance of various bureaucracies better and motivate the administrators more effectively (Amsden, 1989; Wade, 1990). Similar effects may help explain the success of Turkey and Tunisia after their moves towards export promotion in the 1980s.

Another mechanism through which a move towards export promotion may induce more extensive change is the incentives it creates for producers to develop export interests and reduce their stakes in import substitution. This can shift the political calculus of trade policy in favor of more liberal trade, especially when the rising export revenues make it easier to import and starving the domestic demand for imports becomes increasingly unattractive (Esfahani and Squire, forthcoming). The import liberalization trends in Turkey and Tunisia during the 1990s following their shift towards export promotion seem to fit this pattern well.

A more general version of the above process is the so-called "dual-track" reform strategy, whereby some marginal areas in a controlled economy are first liberalized and allowed to expand without generating much risk in the rest of the economy. The success of the liberalized part then generates new resources and stronger incentives for reform in the remaining parts, eventually improving the entire economy in a politically palatable and low-risk manner. China has come to represent a highly successful case of this strategy (Lau, Qian, and Roland, 2000), though MENA countries were indeed pioneers in adopting this approach, starting with Tunisia in 1969 followed by Egypt and Syria in 1974, and Algeria in 1978-79 (Owen, 2004: 115-119). However, unlike China, lack of emphasis on export promotion in

MENA limited the benefits of the approach and turned into a very gradual process of change. Tunisia later shifted to export promotion later on in the mid-1980s and reaped more benefits, probably because of its lack of resource and geopolitical rents.[2]

While policy innovations can initiate strong growth episodes, sustaining high growth in the face of changes in circumstances ultimately requires good institutions. Such institutions may, of course, be built as part of a burgeoning growth process (Rodrik, 2005). But, this point raises another question that has not received much attention in the literature. The circumstances under which small policy changes trigger a virtuous circle of growth and institution building seem to depend largely on informal institutions (e.g., social and political culture). Indeed, it is the informal rules and norms imbedded in culture, religion, etc., that ultimately help formal institutions to function and evolve. In particular, without informal institutions that keep the fabric of society together, it is unlikely that reforms in formal institutions can come about. Some research along these lines has started under the rubric of social capital, though further insights from that field await theoretical development and more detailed characterization and quantification of informal institutions. However, it is important to remain aware of the critical roles that such institutions play in the growth process.

Finally, it should be noted that the multifaceted interactions of resources, politics, and institutions imply that the key factors constraining economic growth may vary greatly according to place and time. To identify the cause of stagnation and appropriate solutions to a country's growth problems at a particular time, one needs to focus on specific circumstances, although it is crucial to work within a theoretically-consistent framework that can inform the choice of relevant factors and suggest hypotheses to be examined. Such studies can help improve the growth process by providing better information to the political and economic actors in each country and, thereby, reducing their contracting problems. This observation also suggests a solution to the dilemma noted by Pritchett (2003) regarding the existing political economy models. He points out that those models are incapable of generating useful policy implications because they assume that everyone is already optimizing subject to the constraints of the system. In other words, any proposed policy improvement must be ignoring or violating some constraint. However, in a world with a myriad of dimensions, even optimizing agents may leave many alternatives unexplored, especially when it comes to the options that require collective action. Just the perception that some forms of coordination are costly may give the players sufficient reason to ignore a host of possibilities, some of which may be potentially productive. The players in such complex games may not know exactly what it is that they must strive to know. Systematic research and lessons from experience

[2] The small size of its domestic market may have also rendered inward looking policy less practical, though this effect does not seem to have been important for Syria. Also, China's large domestic market does not seem to have deterred its commitment to export promotion.

can lower the cost of considering such alternatives and render them feasible; hence a role for political economy research to contribute to economic and institutional reform.

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

3. MENA's Growth Experience: The Roles of Resources, Politics, and Institutions

This section applies the above political economy framework to examine the growth consequences of a number of economic, political, and institutional characteristics that are of broad concern across MENA countries. I start with a discussion of the role of natural resource rents and then examine the geopolitical factors, domestic political divisions, and governance institutions and human resources. The stylized facts used here regarding the nature of the economic situations and policy responses are largely drawn from the other chapters in this volume. In particular, the empirical connections between those conditions and economic growth are based on Makdisi et al. (2005) and Ersel and Kandil (2005), and Salehi-Isfahani (2005).

3.1. Natural Resource Rents

One of the most notable features common to many MENA countries since the mid-20th century is the richness of its natural resource endowments, specially oil and natural gas. Even countries that lack such resources benefit from the region's endowments indirectly through aid from richer countries or remittances from their migrant workers. While there are interesting issues concerning how oil resources are developed and exploited in MENA countries, they are far outweighed by another question: Why have MENA countries not always used their natural resource rents to help their economies grow faster systematically compared to their less endowed counterparts in the developing world? Here, I explore the possible answers to this question as an illustration of how the incomplete contracting framework may be shed light on the subject.

To understand why faster growth is not a systematic consequence of natural resource endowments in MENA, we need to first understand what MENA countries do with the rents. The first notable pattern in this regard is the relatively low rates of taxation of non-oil income in oil-rich countries. Since natural resources in those countries are generally under public ownership, abundance of the related rents has reduced the need for taxation. Although statutory tax rates are in some cases rather high,

especially for the high-income brackets, the typical direct and indirect taxes actually paid remain generally low and finance a relatively small share of the government budget. Interestingly, the low tax rates have not translated into encouragement for investment and growth in many MENA countries. This seems to be partly because of uncertainty in the net returns to production, which could be related to fluctuations in oil revenues. We will explore the reasons for this below.

Another important part of oil rents is spent on large government bureaucracies as well as financing infrastructure and production projects. The latter part could, in principle, be a growth stimulant. However, that role is often undermined due to the inefficiencies in investment and operation of public enterprises (PEs) and infrastructure.

Finally, the bulk of the remaining revenues are used in the form of transfers and mass subsidies. As Esfahani (2003) shows, in oil-rich countries of MENA the subsidy on gasoline consumption alone ranges between 1 to 5 percent of GDP. Subsidies are also offered for a variety of other items, especially other forms of energy, staple foods, and credit. This use of resource rents has had limited potential for generating economic growth.

So, why do MENA countries often use their resource rents in these ways rather than channeling them more effectively towards growth? From a contracting perspective, inefficiency arises when the politicians who need to elicit support from the public or politically influential interest groups cannot make them the residual beneficiaries of efficient uses of public funds. For example, the funds subsidizing redundant workers in a PEs could be used for creating more productive jobs, but the workers may not consent to such reallocation if they believe that they may not be the beneficiaries of those jobs, or if they suspect that the funds may simply be diverted to other inefficient uses. Similarly, the public may understand that mass subsidies on fuel are inefficient, but if it cannot trust that the politicians will use the saved subsidies to produce a better outcome, broad support for the subsidies may remain strong (Esfahani, 2003). This may not be a concern for democratic regimes that are under close public scrutiny. It may also not matter for authoritarian regimes that can rule with narrow support, at least for a while, as in the case of the Shah's government in the 1960s, which raised the price of fuel and generated substantial funds for its projects. However, most MENA governments rely on some form of public support or acquiescence, without being fully trusted. As a result, when they have access to rents, they feel the need to offer subsidies because the public does not have high hopes of seeing those funds be applied towards more efficient alternatives of broad interest. Even if the government intends to make good use of the funds, specifying the details of what must be done and assessing the outcome are often extremely difficult because the factors involved and the possible states of the world are rarely practical. As long as there are opportunities for misallocation or embezzlement of rents, the pubic is likely to prefer upfront transfers

through inefficient subsidies or expenditures, rather than allowing the funds to remain in the hands of the politicians and waiting for possible efficient uses. Upfront subsidies offered in the form of low food and energy prices also act as effective coordination mechanisms for the public to react collectively to policy changes. This may explain why the removal of subsidies has often triggered widespread riots, forcing governments to rescind price hikes at least partially in many cases, as in Iran in 1969, Egypt in 1977, Morocco and Tunisia in 1984, Jordan in 1989 and 1996, and Yemen in 1998 and 2005. It is also notable that the expanded role elections in Iran after the 1979 Revolution has been associated with increased mass subsidies.

The above discussion suggests an important reason why resource rents may not have been channeled towards growth. It can also shed light on the slowdown of growth in MENA economies in 1980s and 1990s and their vulnerability to the decline in oil prices in those years. Note that the optimal policy for spending oil revenues would have entailed saving part of the funds during resource booms and to create a stabilization fund to be spent during bust years (or paying back during booms the loans accumulated during troughs). However, that type of policy would have faced the same difficulty as the attempt to put them into more productive uses: The public and most interest groups would have been skeptical about ever benefiting from the saved funds and would not have easily consented to moving them out of current consumption. Indeed, few oil-exporting developing countries other than Kuwait have reached sufficient coordination in their fiscal policies to restrain their expenditures in major ways during boom times. Many MENA countries have done the exact opposite, borrowing during booms when their creditworthiness has risen and paying back with difficulty during busts when foreign lending has dried up. In some cases, this pattern has further forced the government to inflationary financing, as in the cases of Algeria, Egypt, Iran, and Syria during many years the 1980s and 1990s (see Table 2).[3] For some countries without oil revenues the inflation problem has been more chronic, as in Turkey. In either case, the consequence in most countries has been economic slowdown and macroeconomic instability.

The above discussion points to some specific ways in which politics and institutions have interacted with resource rents, shaping the pattern of economic performance in region. Further causes and consequences of contracting problems, especially the coordination failures that have contributed to the outcome, will be discussed below.

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[3] Note that the overall record of inflation in MENA is much better than that of most of the developing world, as Table 2 shows. The point here concerns the rise and decline of inflation in some countries during some periods.

Table 2
Price Volatility in MENA Countries

Country*	Average CPI Inflation Rate								Standard deviation of CPI for the years available
	Period:								
	1965-1970	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2004	
Oil Exporting									
Algeria	n.a.	4.75	11.70	8.96	9.10	24.75	12.36	2.43	8.38
Bahrain	2.36	10.25	14.88	5.48	-0.98	0.98	0.61	0.25	6.99
Iran	1.53	7.27	14.73	19.16	20.48	20.64	26.78	14.26	10.31
Kuwait	0.00	10.63	1.78	5.60	1.58	4.25	2.01	1.40	5.79
Libya	8.23	1.36	8.40	11.39	4.88	9.18	4.23	-7.17	7.30
Oman	n.a.	n.a.	n.a.	n.a.	n.a.	1.42	0.49	-0.58	1.56
Qatar	n.a.	n.a.	n.a.	4.97	2.82	2.19	3.58	2.48	2.31
Saudi Arabia	1.82	9.39	15.41	1.32	-1.17	1.70	0.89	-0.21	8.32
Yemen	n.a.	n.a.	n.a.	n.a.	n.a.	37.64	20.53	9.89	17.82
Non-Oil Exporting									
Egypt	5.26	4.83	10.74	15.82	18.92	14.08	6.90	4.69	6.58
Jordan	n.a.	9.79	11.84	7.02	7.02	7.04	3.12	1.85	5.89
Morocco	1.02	6.17	9.41	10.22	4.93	6.19	2.72	1.62	4.24
Syria	1.45	9.65	8.84	13.47	31.75	13.59	2.72	0.04	12.23
Tunisia	n.a.	n.a.	n.a.	8.90	7.32	5.85	3.89	2.78	2.21
Turkey	5.06	13.12	33.52	51.47	51.07	73.74	80.74	37.63	30.01
Non-MNA Oil Exporters**	**2.41**	**6.64**	**13.78**	**13.77**	**27.56**	**39.32**	**38.78**	**23.72**	**19.63**
Non-MNA Non-Oil Exporters**	**20.71**	**16.69**	**33.66**	**43.24**	**130.55**	**68.83**	**12.50**	**8.23**	**121.62**

n.a. Not available.

* Djibouti, Iraq, Lebanon, UAE, and West Bank and Gaza are not included due to lack of sufficient data.

** Weighted averages, with each country's PPP GDP serving as its weight. Oil exporters consist of Angola, Republic of Congo, Gabon, Nigeria, Trinidad and Tobago, and Venezuela.

Source: Calculated based on World Bank's *World Development Indicators*.

Table 3

Public Employment in MENA Countries
Compared to the Weighted Average of Non-MENA Developing Countries*

	Total Public Employment as Percent of Labor Force		Public Enterprise Employment as Percent of Labor Force	
Country	**1991-1995**	**1996-2000**	**1991-1995**	**1996-2000**
Oil Exporting				
Algeria	n.a.	19.5	7.0	3.5
Bahrain	26.9	n.a.	n.a.	n.a.
Iran	26.3	21.9	n.a.	4.2
Kuwait	n.a.	40.0	n.a.	3.7
Libya	44.9	n.a.	1.41	n.a.
Oman	21.5	16.4	n.a.	7.9
Qatar	n.a.	29.4	n.a.	0.8
United Arab Emirates	n.a.	n.a.	1.98	n.a.
Yemen	n.a.	14.5	n.a.	1.66
Non-Oil Exporting				
Egypt	23.8	25.8	13.3	5.0
Jordan	17.1	16.9	n.a.	1.4
Lebanon	8.3	8.1	0.6	0.3
Morocco	n.a.	7.2	n.a.	0.7
Syria	n.a.	n.a.	n.a.	10.0
Tunisia	n.a.	n.a.	5.1	n.a.
Turkey	10.2	9.6	3.0	2.3
Weighted Average of Developing non-MENA Countries*	**13.8**	**11.4**	**4.0**	**2.7**

* The developing countries included in the average are those with data for both sub-periods. For China, public employment data excludes those in town and village enterprises. Labor force is used as weights across countries.

Sources: ILO, Public Sector Employment Database, the website for the *International Labor Statistics*; World Bank, *Public Sector Employment database, 2002*, and World Bank, *World Development Indicators 2000*.

In the absence of well developed credit and insurance markets (Ersel and Kandil, 2005), the considerable terms of trade fluctuations, the consequent instability, and the availability of public resources during booms must have jointly contributed to the rise and maintenance of extensive PE sectors and large general public employment as social insurance substitute in MENA countries. (For the available

public employment data, see Table 3. A similar conclusion can be drawn, particularly in the case of MENA's oil exporting countries, from the subjective indicators of government intervention and ownership shown in the first column of Table 4 based the rankings carried out by the Heritage Foundation).[4] In addition, many MENA governments, especially non-oil exporters, have tried to address the demands for the economic security among private sector low-income workers by restricting layoffs. This can be seen in the last column of Table 4, which shows the employment rigidity rankings developed by the World Bank. Of course, such policies provide job security only for the employed workers at the cost of employers and potential entrants into the job market.

The need to manage economic risk through second or third best government-controlled mechanisms may have also strengthened protectionist incentives during the 1990s (Esfahani and Squire, forthcoming). However, the recovery of oil prices in recent years seems to have changed this trend and has enabled MENA's major oil exporters to ease trade restrictions (see the middle columns of Table 4). For the rest, except for a few countries, liberalization has not proceeded as fast after the 1990s. Interestingly, the overall rates of protection in MENA countries before the 1990s used to be below those in most other developing regions (Esfahani and Squire, forthcoming). Indeed, the presence of PEs and other redistribution mechanisms helped MENA governments reduce the impact of openness on parts of population that could potentially lose as a result of foreign competition. That situation, however, changed when per capita oil revenues declined in the 1990s and MENA countries began to look more inward while most of the developing world raced towards greater economic integration.

Besides their impacts on policy outcomes, natural resource rents have influenced the evolution of political institutions in MENA countries. Because the ruling elites did not have to rely much on taxation, they have found it easier to continue their rule without much representation (Mahdavi, 1970; Elbadawi and Makdisi, forthcoming). The rents have allowed the ruling politicians to buy support from interest groups, rather than being responsible to the tax-paying public. In this way, abundance of natural resources may have contributed to the survival of authoritarian regimes in the region. More on this in section 3.4 below.

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[4] Objective and accurate data on public enterprises is limited, especially for MENA countries. Despite those imperfections, the picture constructed by Tables 3 and 4 is suggestive about the extensive nature of public employment and ownership in MENA, especially in the case of oil exporting countries.

Table 4

Government Intervention, Trade Restrictions, and Employment Rigidity in MENA Countries Compared to the Weighted Average of Non-MENA Developing Countries*

Country	Government Intervention and Public Ownership		Trade Restrictions		World Bank's Index of Labor Market Rigidity
	1995-2000	2001-2005	1995-2000	2001-2005	2004
Oil Exporting	**4.3**	**4.6**	**4.7**	**3.8**	**38.7**
Algeria	3.7	4.1	5.0	4.6	55.0
Bahrain	4.2	4.3	2.0	3.0	n.a.
Iran	4.4	4.9	5.0	3.4	40.0
Iraq	5.0	5.0	5.0	5.0	n.a.
Kuwait	4.7	4.5	2.0	2.2	20.0
Libya	5.0	4.6	5.0	5.0	n.a.
Oman	4.4	4.5	2.6	3.0	35.0
Qatar	3.5	4.6	2.5	2.8	n.a.
Saudi Arabia	4.4	4.7	4.2	4.0	13.0
United Arab Emirates	4.0	4.0	2.0	2.0	33.0
Yemen	4.0	4.1	4.8	3.4	37.0
Non-Oil Exporting (Excluding Turkey)	**3.1**	**3.3**	**4.7**	**4.5**	**54.2**
Egypt	3.0	3.4	5.0	4.4	53.0
Jordan	3.7	3.5	4.0	4.2	34.0
Lebanon	2.5	3.0	3.8	3.8	28.0
Morocco	3.1	2.7	4.5	4.8	70.0
Syria	3.8	4.3	4.4	4.6	37.0
Tunisia	3.5	3.1	5.0	5.0	54.0
Turkey	2.0	2.5	1.8	2.6	55.0
Non-MENA Oil Exporters*	**3.1**	**4.0**	**4.8**	**4.7**	**47.5**
Non-MENA Non-Oil Exporters*	**3.3**	**3.2**	**4.2**	**4.1**	**41.4**

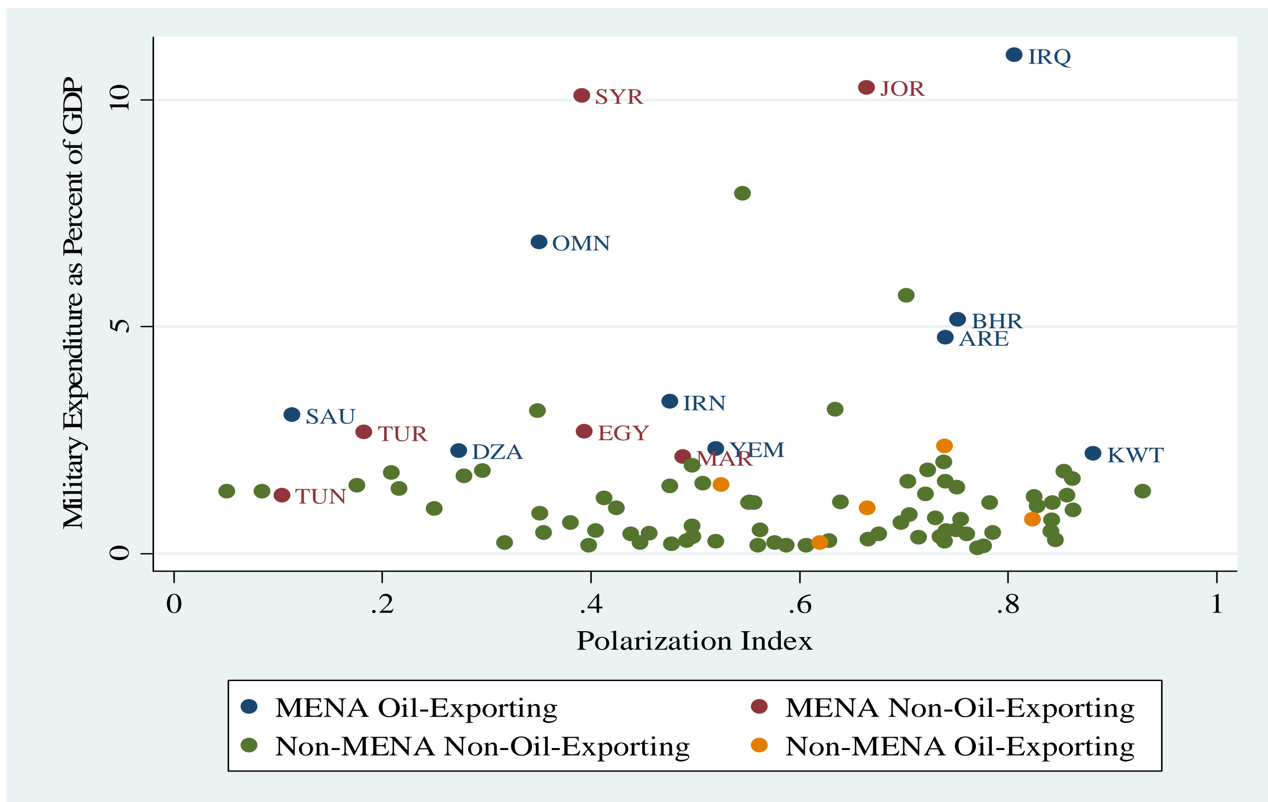
n.a. Not available.

* World Bank's rigidity of employment index ranges from 0 (= least rigid) to 100 (= most rigid). Other indices range from 1-5, with higher numbers representing less market friendly policies. For variable definitions, see Appendix Table A1. The developing countries included in the average are those with available data for both sub-periods. Labor force is used as weights across countries. Non-MENA Oil exporters are Angola, Rep. of Congo, Gabon, Nigeria, Trinidad & Tobago, and Venezuela.

Sources: The Heritage Foundation, *Index of Economic Freedom*, and the World Bank, *World Development Indicators*.

Figure 4

Polarization and Military Expenditure in Developing Countries*



* Polarization index is the average of polarity of ethnic and religious distributions according to the measure proposed by Montalvo and Reynal-Querol (2005).

Source: Montalvo and Reynal-Querol (2005) and *World Development Indicators*.

3.2. Heterogeneity and Polarization

As we have seen in section 2, MENA societies are not particularly fractionalized, but several of them are quite polarized (Figure 3). The latter pattern has been a major source of internal conflicts in the region. In particular, Kurdish minorities and other ethnic groups in Iran, Iraq, and Turkey have at times engaged in political and even armed conflict with their respective governments. Also, Lebanon, Yemen, and Oman have been the scenes of destructive civil wars. Other examples are the war in Western Sahara and the (often less intense) conflicts between Berbers and Arabs in North Africa. Along with international conflicts (especially, the Arab-Israeli conflict), these tensions have strengthened the role of military establishments in several MENA countries and have provided justification for repressive government policies. This is reflected in Figure 4, which maps military expenditure as share of GDP against the polarization index of Montalvo and Reynal-Querol (2005). It is notable that the two indices are not

correlated outside MENA region, but are positively related within the region in a way that affects the pattern for the developing world as a whole. Also, as the lower panel of Figure 3 shows, polarization seems to be negatively related to growth within MENA region, even though the relationship of the two is very weak in the rest of the developing world.

While there is some evidence at the macro level indicating that ethnic conflicts adversely affect policy outcomes, the details of the connections are not yet very well understood. As Bates (1999) argues, ethnic divisions need not lead to conflict and may in fact positively affect economic performance under some conditions. Certainly, ethnic divisions tend to increase internal cohesion within each ethnic group, which may help solve a great deal of free-rider problems that arise in more amorphous societies. These issues are worth pursuing in future political economy studies to develop a better understanding of positive and negative effects of ethnicity on economic policy and to search for ways in which the negative effects can be mitigated. Some considerations along these lines will be discussed in the next section on geopolitical issues and the role of military.

Polarization is may have more far-reaching effects on economic policy and growth that have not yet been explored. For example, increased polarization may raise the incentives for intense government intervention in social and political organizations as well as in markets, as a means of controlling potential conflict. At least, governments seem to extend their direct controls over economic activity during periods of heightened political tension. More long-term consequences of such incentives as well as other possible effects of polarization are worth further study.

3.3. Geopolitical Rents and Threats and the Role of Military

As we have seen, military expenditure as a percentage of GDP in MENA region is by far the highest in the world. Commensurately, the region has had its share of wars. Besides the internal factors noted above, the demand for military expenditure in the region originates in the international conflicts. The Arab-Israeli conflict remains the most significant and stifling one, as reflected in the large resource allocation to armed forces in Israel and its neighbors. Disputes between Iran and its Arab neighbors have also had similar, though less pronounced, effects in those countries. However, militarization has also been supported by superpower strategies and rivalries, which at times have subsidized those expenditures and offered rents to strategic MENA countries. Prior to the fall of Soviet Union, the list included Iran, Iraq, and Syria, but nowadays Egypt, Israel, and Turkey remain the most prominent beneficiaries of such rents. (Iraq may rejoin the group once it recovers from war.)

The role of geopolitical rents goes beyond military subsidies and includes support for the ruling politicians in MENA countries. Along with the natural resource rents, this is another factor that may have

helped the longevity of dictatorships in the region (Elbadawi and Makdisi, forthcoming). A number of scholars have further suggested that external rents may have weakened the urge to implement market-oriented reforms in the region (Richards, 1991; Löfgren, 1993). This issue, which has been more broadly debated in the context of the role of foreign aid, remains to be fully analyzed. The issue is that countries with easier access to foreign aid can be in a better position to pursue objectives such as rent redistribution and stability with less distortion in domestic production or foreign trade. The reason why they maintain distortions may lie in institutional weaknesses, as in the case of resource rent use.

Domestic and international conflicts have provided the military establishments in MENA with reasons to grow and to gain control over resources not only by way of weapons and personnel, but also in the form of economic activities. In many MENA countries, the military owns and runs business conglomerates that produce military as well as civilian products (Richards and Waterbury, 1990: 360-367). Because of their superior political position and subsidized inputs (including draftees who come at low cost), these conglomerates compete well in domestic markets and government contract auctions. As a result, they have turned into economic forces that have influenced the path of trade and industrial policies.

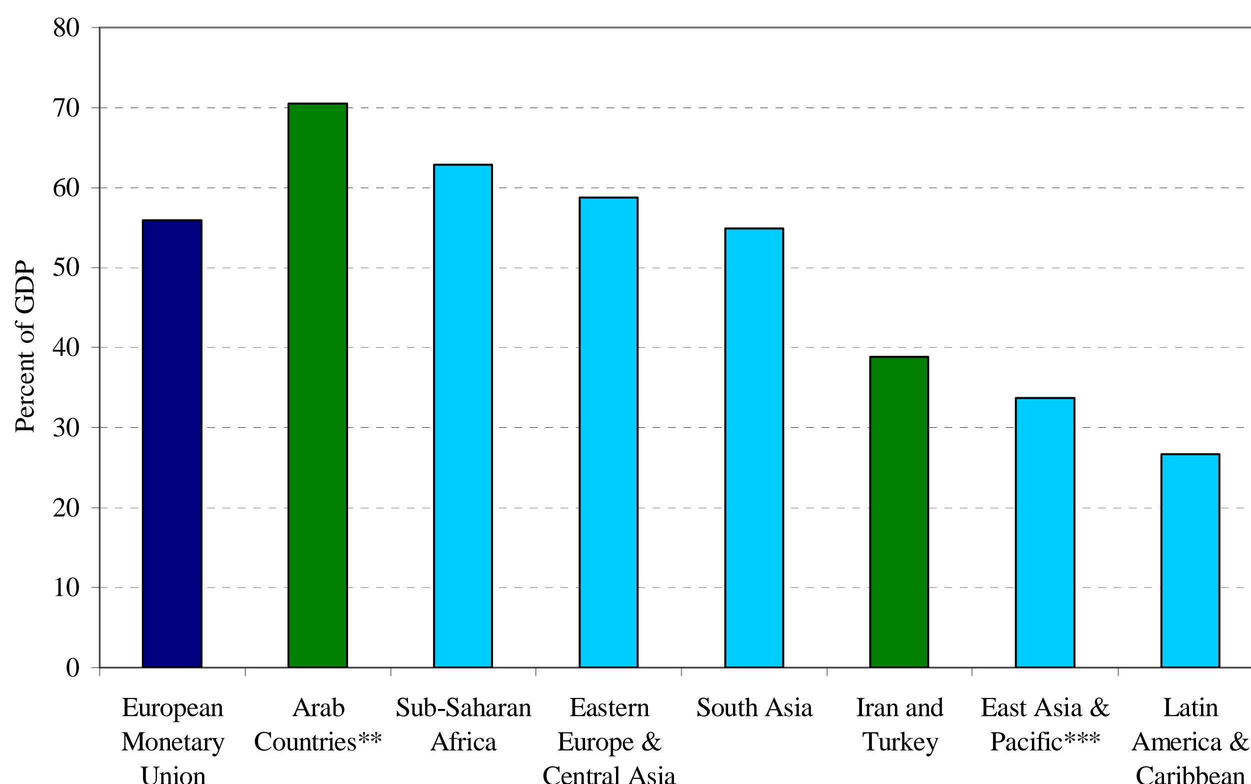
As pointed out earlier, greater control of resources by the military does not seem to be negatively correlated with economic growth in MENA (Yildirim et al., 2005). This may be due to the role of military in providing basic internal and external security and in forcing solutions to persistent internal conflicts. The latter issue is particularly important in the context of polarized societies where there are severe contracting problems among contending groups and the military ends up providing a context for renegotiation and conflict resolution. For example, the political turmoil in Turkey in the 1970s ultimately came to an end through a military coup in 1980. Solutions of this type imposed by the armed forces may not be fair, but they can be more productive than the continuation of turmoil.

3.4. Authoritarianism

Political institutions in most MENA countries have been relatively stable but autocratic compared to those in comparable countries. (See the first two columns of Table 5. The measures presented in the table are derived from a combination of subjective and qualitative indices. Such institutional measures are, of course, not precise and should be treated only as indicative.) These characteristics must be an important part of any explanation of policy and performance in the region over the past few decades. Most conspicuously, regime longevity and centralization of decision-making seem to have afforded reasonable coordination at the macro level, mitigating the possible negative effects of polarization. This is particularly evident in the relatively low inflation rates in many MENA countries compared to the rest of the developing world. Many Arab governments do have high levels of debt (see Figure 5), but as Esfahani (2005) shows, that fact actually indicates creditworthiness, which can be attributed to reasonable levels of

coordination and institutional capability, though not sufficient discipline to limit borrowing to the amounts needed strictly for tax smoothing. Interestingly, in Iran and Turkey where discipline has been weaker, government debt has been constrained at much lower levels (Figure 5).[5] Similar coordination effects may have also helped many MENA countries score better than their counterparts elsewhere in terms of qualitative indices of government effectiveness, rule of law, and control of corruption (Table 5).

Figure 5
Central Government Debt as Percentage of GDP Across Regions*
Regional Weighted Averages over 1997-1999



* Averaged using GDP weights over countries for which data is available.

** Algeria, Bahrain, Jordan, Lebanon, Morocco, Oman, and Tunisia.

*** Excluding China. Central government of China has a low debt and, if included, dominates the region, lowering the average public debt down to 16.7 percent of GDP.

Sources: World Bank, *World Development Indicators*, 2004, and Joint BIS-IMF-OECD-WB Statistics on External Debt, www.oecd.org/site/0,2865,en_21571361_31596493_1_1_1_1_1,00.html.

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[5] Note that the more democratic countries such as Turkey have also experienced higher inflation rates. Inflation in Iran also accelerated after the 1979 Revolution when its political system became less autocratic. These correlations do not mean that democracy is always a cause of price instability. Rather, the point is that democratization with weak policymaking institutions is likely to entail coordination failures in many policy areas.

Table 5
Governance Indicators n MENA Countries, 1996-2004 Averages*

Country	Voice and Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
Oil Exporting	**–1.2**	**–0.9**	**–0.5**	**–1.1**	**–0.6**	**–0.5**
Algeria	–1.2	–2.0	–0.7	–0.8	–0.7	–0.6
Bahrain	–1.0	0.0	0.6	0.9	0.8	0.5
Iran	–1.0	–0.5	–0.4	–1.4	–0.6	–0.6
Iraq	–1.9	–2.4	–1.6	–2.7	–1.7	–1.4
Kuwait	–0.3	0.4	0.2	0.1	0.9	0.9
Libya	–1.6	–0.7	–1.1	–2.0	–0.9	–0.9
Oman	–0.7	0.9	0.9	0.6	1.1	0.7
Qatar	–0.7	1.1	0.8	0.2	1.0	0.6
Saudi Arabia	–1.4	–0.1	–0.1	–0.1	0.6	0.2
UAE	–0.7	1.0	0.7	0.8	1.1	0.8
Yemen	–0.8	–1.2	–0.7	–0.6	–1.0	–0.6
Non-Oil Exporting (Excluding Turkey)	**–0.8**	**–0.2**	**–0.1**	**–0.2**	**0.1**	**–0.1**
Egypt	–0.9	–0.4	–0.1	–0.2	0.1	–0.2
Jordan	–0.3	0.0	0.4	0.3	0.4	0.1
Lebanon	–0.5	–0.5	–0.2	0.0	–0.2	–0.4
Morocco	–0.5	–0.1	0.1	0.1	0.2	0.1
Syria	–1.6	–0.4	–0.8	–1.0	–0.4	–0.6
Tunisia	–0.8	0.4	0.8	0.1	0.3	0.3
Turkey	–0.5	–0.9	–0.1	0.3	0.1	–0.2
Non-MENA Oil Exporters**	**–0.9**	**–1.3**	**–1.1**	**–0.8**	**–1.2**	**–1.1**
Non-MENA Non-Oil Exporters**	**–0.1**	**–0.5**	**–0.2**	**–0.2**	**–0.3**	**–0.4**

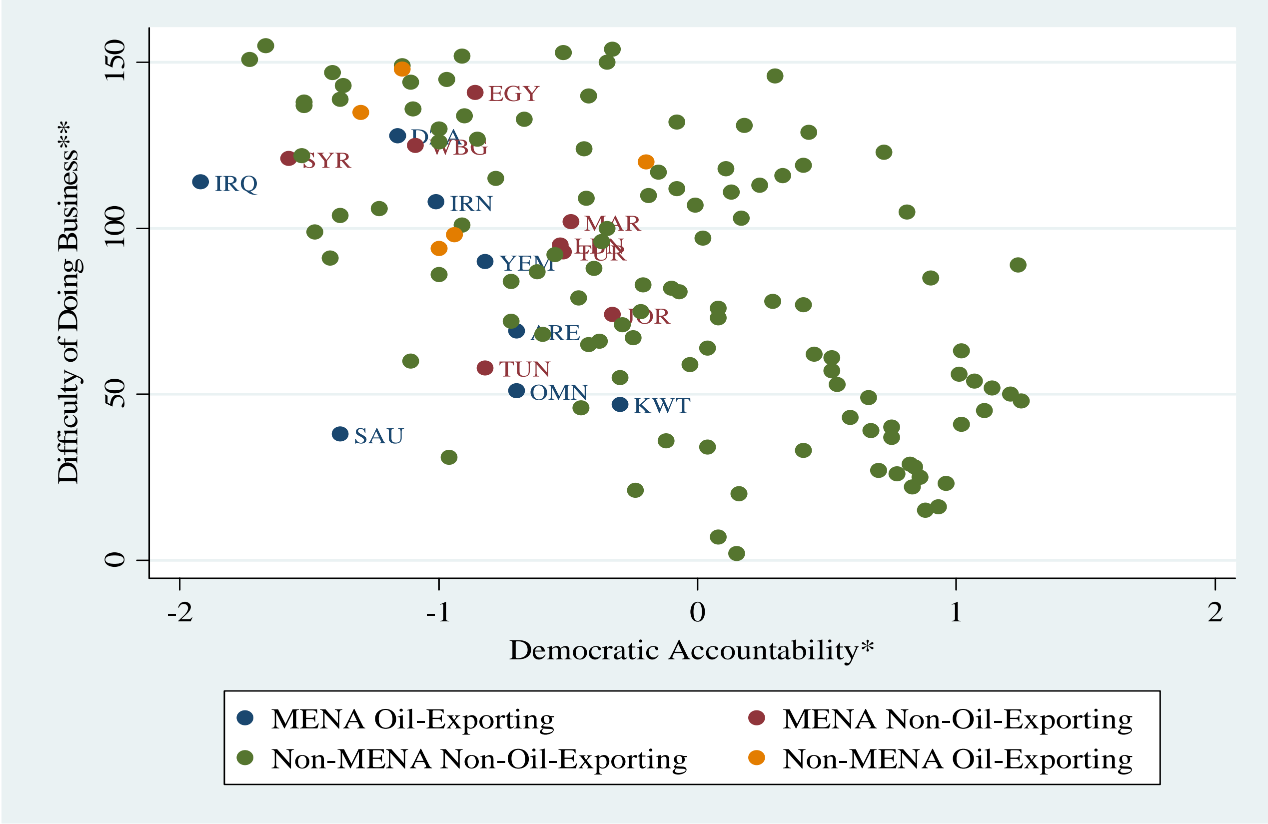
* Units of all indices are expressed in terms of standard deviations of rankings around zero.

** The developing countries included in the average are those with available data for both sub-periods. Labor force is used as weights across countries. Non-MENA Oil exporters are Angola, Rep. of Congo, Gabon, Nigeria, Trinidad & Tobago, and Venezuela.

Source: D. Kaufmann, A. Kraay, and M. Mastruzzi. 2005. "Governance Matters IV: Governance Indicators for 1996-2004," World Bank Website, http://www.worldbank.org/wbi/governance/govdata/.

The ability of many MENA countries to solve some macro contracting problems through authoritarian rule has come partly at the cost of misinformed and poor quality policymaking at the micro level. Figure 6 depicts one way that this tradeoff manifests itself. It shows that across countries, accountability is inversely related the difficulty of doing business (measured by rank in terms of a survey-based index developed by the World Bank). Specifically, MENA countries mostly fall on the upper left part of the chart, reflecting a situation where businesses that are independent of the government and ruling politicians have little say in policy and face difficulties starting up, growing, and adjusting to economic conditions. Similar problems can be observed in terms of poor quality of services with public good components, such as education and healthcare (World Bank, 2003). Such effects mute the dynamism of the economy at the micro level and counteract with the gains from coordination at the macro level.

Figure 6
Democratic Accountability and Ease of Doing Business



* Combined index of voice and accountability calculated by Kaufmann et al. Units are standard deviations of rankings around zero.

** Based on rank calculated by the World Bank in terms of ease doing business. Higher numbers indicate greater difficulty of doing business.

Sources: D. Kaufmann, A. Kraay, and M. Mastruzzi. 2005. "Governance Matters IV: Governance Indicators for 1996-2004," World Bank Website, http://www.worldbank.org/wbi/governance/govdata/. World Bank, "Doing Business: Economy Rankings," http://www.doingbusiness.org/EconomyRankings/.

Another way of viewing the cost of doing business under centralized MENA regimes is the weaknesses of policy commitment at the micro level. Indeed, changing policies without due process has been a major complaint of domestic and foreign businesses in MENA countries. Esfahani (1997) offers a host of examples. For instance, in Egypt, following the rise in foreign investments in 1981, the Minister of Energy decided to raise the price of energy and petroleum products for FDI projects by a factor of 3, bringing it to the world market level. He argued that the substantially subsidized domestic price was for users who did not enjoy the privileges of the foreign investment code (Middle East News Agency, *Economic Weekly*, 1989, May 19: 13). Given that the privileges were supposed to be incentives for foreign investors and those who had invested in Egypt had assumed a uniform price of energy, the policy change placed FDI projects at a disadvantage vis-à-vis their Egyptian competitors. Some investors were so disappointed that they closed their operations (Sadowski, 1991: 115).[6] There are also many other examples where governments simply cancel contracts granted to foreign investors. Just recently, the government of Iran helped a local mobile phone company, Irancell, to cancel its $3 billion contract with a Turkish company, Turkcell (Turkish Industrialists' and Businessmen's Association (TUSIAD), *Turkey News*: September 6-18, 2005). Another contract with the Turkish operator of Khomeini International Airport was repealed last year due to pressure from Iran's Revolutionary Guards, claiming security concerns (TUSIAD, *Turkey News*: January 25-February 1, 2005).

The impact of authoritarianism on economic activity has not been uniform across MENA countries. In particular, the extent and form of government involvement in the economy seems to have systematically varied between monarchies and republics. In monarchies, the survival of the traditional relations of power and the established elite has ensured support for private property, whereas in republics, state ownership has often been used as a means of dispossessing old propertied classes and establishing new orders by subordinating production to the political imperatives of new regimes (Owen, 2004: 45-53). Indeed, the extension of government controls over the economy has been quite visible after the formation of republics in Algeria, Egypt, Iran, Syria, and Tunisia. There are, of course, other forces at work that explain the public sector growth in monarchies or in the case of less authoritarian republics (Turkey in the 1960s) as well—e.g., partial solutions to market failures and the connection between resource rents and public ownership discussed earlier. Many details of such effects and their interactions (e.g., the interaction of authoritarianism and polarization) in shaping economic policy await careful scrutiny.

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[6] Another relevant example from Egypt is the cancellation of a US firm's contract for the management of duty-free shops at the Cairo airport. The contract was subsequently awarded to Egypt's major public sector airline, EgyptAir, which has been benefiting from the support of airline industry regulators in many other respects, e.g., the limitation of charter flights to Cairo (*Business Middle East*, The Economist Intelligence Unit, 1995, November 16-30: 10).

Although the survival of authoritarianism in MENA has been facilitated by natural resource rents and internal and external conflicts, the institution has deeper social and cultural roots as well. These roots have long been debated in the political economy literature, going at least as far back as Marx's idea of "Asiatic Mode of Production." Whether the root causes will continue to exert their influence in the coming decades or not is an important question. However, it appears that the changing composition of endowments in the region is counteracting with the old causes and is bringing about institutional change. In recent years, there have been persistent efforts to bring about democracy in a number of countries, as in the case of Iran. Many observers have attributed these efforts to the gradual rise of human capital relative to the natural resource rents as a source of income. The more educated labor forces of MENA countries demand greater participation, organize and articulate their positions better, and when governments ignore them, their increased mobility imposes larger costs on local economies and ultimately on governments.

While democratization is desirable for a variety of reasons, from an economic policy perspective it also poses major challenges. The improved representation under democratic conditions makes coordination more difficult. For example, there is a great deal of historical and cross-country evidence that the expansion of franchise increases demands on public expenditures (Shelton, 2005). Also, compared to stable autocracies, democracy tends to increase the turnover in the leadership. This shortens the horizons of policymakers in office and can weaken their incentives to coordinate or even represent the polity's interests. In MENA countries, where tax administration is underdeveloped and resource rents are declining, these demands may lead to unsustainable budget deficits, a problem that Turkey has experienced for a few decades as it has moved towards a more established democracy. Countering these effects requires a great deal of institution building to enable competing interest groups coordinate their actions in the macroeconomic policy area. Similarly, without enhancing the coordination mechanisms, democratization may increase the demand for protection and undermine the prospects of trade liberalization.

Another implication of democratization in a world of imperfect contracts is the particular difficulties that countries with large resource rents tend to face. As discussed in section 3.1, when the public knows that the government has access to large rents that may be diverted to particular interests, the voters become keen to capture their shares through the imperfect means that a nascent democracy provides. As a result, mass subsidies and various forms of protectionism may expand in the early stages of democratization process, giving rise to greater distortions in the economy (Esfahani, 2003). This implies that the democratic transition may be particularly difficult times for MENA economies with well-endowed resources.

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

Along with democratization, a process of decentralization is likely to start in some MENA counties. This is a natural development and may contribute to the quality of public services at the local level. However, like democratization, its success is contingent on a set of complementary institutions that ensure coordination at the macro level. The unfortunate experiences of Brazil and Argentina with decentralization in the 1980s and their contrast with the operation of decentralized systems in China and India, among many others, contain important lessons for arrangements that must accompany decentralization to ensure success. (For important lessons from the case of China, see Qian, 2003).

3.5. Human Capital

Until about 1980, educational attainments in MENA were quite low compared to other developing countries (Table 6).[7] This was largely the legacy of the region's traditional and tribal social structures, though in some areas it has been reinforced by colonial policies (Ayubi, 1995). However, over the past few decades, most MENA countries have been quickly catching up with their peers in terms of schooling quantity, though the achievement is less solid on the quality dimension (Salehi-Isfahani, 2005).

The attention given by MENA governments to education in recent decades started with the post-WWII social contracts promising improvement in the living conditions for broad segments of the population. Expansion of education also served as part of the state's effort to extend its control and shape the development process. Like other dimensions of government controls, the extension of education came easier in quantitative terms and was to some extent complementary to those dimensions (e.g., educating the workforce that was to fill the newly created government jobs). However, extensive government controls of over economic activity seem to have generated negative interactions with education quality.

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[7] This is based on years of schooling. Data on literacy rates reveal similar patterns.

Government jobs focused the goals of the educational system on minimum skills and degrees, rather than entrepreneurship and creativity (Salehi-Isfahani, 2005). The widespread interventions also diverted the government's attention and resources away from more fundamental improvements in educational quality.[8] Weakness of administrative institutions discussed below has further contributed to the problem, and may at the same time have been partly caused by educational deficiencies. In any event, a manifestation of the phenomenon seems to be the apparent puzzle of low economic growth in the face of rapidly expanding education in MENA (Pritchett, 1999). If this conjecture is correct, we should before long observe much higher social returns to education in countries that manage to expand the role of private markets.

Table 6
Average Years of Schooling in MENA Countries, 1970-2000*

Country	1970	1980	1990	2000
Oil Exporting	**0.97**	**1.91**	**3.34**	**4.69**
Algeria	0.82	1.56	3.01	4.72
Bahrain	1.82	3.12	4.87	6.09
Iran	1.01	1.93	3.36	4.66
Iraq	0.76	1.83	3.20	4.34
Kuwait	2.88	4.29	5.99	7.05
Libya	1.38	2.22	3.37	4.67
Non-Oil Exporting	**1.53**	**2.24**	**3.40**	**4.51**
Egypt	1.25	2.21	3.57	5.05
Jordan	2.29	2.93	5.39	7.37
Syria	1.67	2.86	4.35	5.74
Tunisia	0.91	1.92	3.02	4.20
Turkey	2.16	2.80	3.95	4.80
Non-MENA Oil Exporters**	**1.20**	**1.91**	**2.54**	**3.52**
Non-MENA Non-Oil Exporters**	**2.94**	**3.77**	**4.80**	**5.37**

* MENA countries shown in the table are only those for which data is available.
** The developing countries included in the average are those with available data for both sub-periods. Labor force is used as weights across countries. Non-MENA Oil exporters are Angola, Rep. of Congo, Gabon, Nigeria, Trinidad & Tobago, and Venezuela.

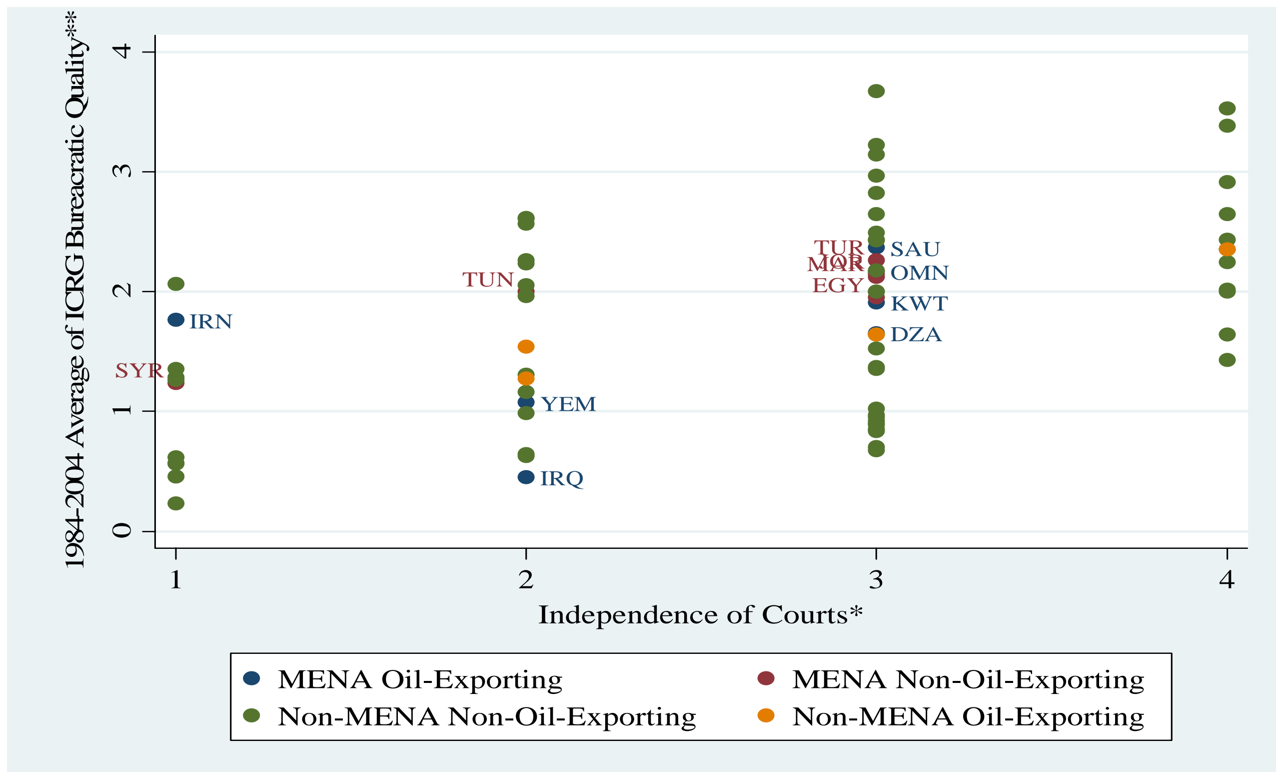
Sources: Barro-Lee education data available from the NBER website, www.nber.org. Labor force data extracted from the World Bank, *World Development Indicators* website.

[8] Financial resources, of course, were less of a constraint for oil-exporting MENA countries, which have managed to achieve substantial improvement in schooling since the 1970s (see Table 6).

3.6. Administrative and Judicial Institutions

Administrative and judicial institutions are not particularly effective in MENA region. (Figure 7 shows two indicators in these respects, though the numbers are subjective and subject to the usual caveats.) Typically, court cases take long times to settle and there is considerable concern among the public that judgment may not be competent and impartial. Also, in most MENA countries, bureaucrats are viewed as lacking sufficient competence and impartiality (World Bank, 2003).

Figure 7
Court Independence and Bureaucratic Quality across Developing Countries



* *Court Independence* is a subjective ranking of autonomy of courts for the early 1990s. The range is 0-4 and higher scores indicate greater independence.

** *Bureaucratic Quality* is a survey-based subjective measure of autonomy from political pressure and strength and expertise to govern as well as the existence of an established mechanism for recruiting and training. The range is 0-4 and higher scores indicate higher quality.

Sources: Charles Humana, *World Human Rights Guide* (1992) and Political Risk Services, Inc.

Effectiveness in judicial and administrative services is highly desirable because these are valuable and crucial public goods particularly for improving contracting conditions in both private and public arenas. However, building a strong bureaucracy and judiciary has posed a number of dilemmas for

developing countries. One fundamental problem is that reforming these institutions requires some capability to design and to carry out policies (or deals and contracts) that in turn depend on having capable administrators and state organizations in the first place. Although there are strategies of starting from some parts of these institutions and gradually rebuilding the system, implementing those strategies often faces a number of problems. In authoritarian countries, it is usually difficult for the rulers to grant sufficient autonomy and power to bureaucrats and judges to enable them to move forward with the necessary reforms. This is particularly the case because some partiality in those organizations is needed for maintaining the structure of power. In new democracies, on the other hand, the difficult task is to coordinate a multitude of players and convince each that all others will be cooperating to ensure a desirable long-term outcome for the reforms.

Currently, there is limited knowledge concerning the requirements of reform and the details of judicial and administrative institutions that match each country's conditions. Despite voluminous literature on these subjects, careful analytical work on them remains inadequate. Recently, some systematic research on these subjects has started (see, for example, La Porta et al., 2004). More work along those lines and applications to MENA countries should be an important part of further research on the political economy of growth in the region.

4. Conclusion

The factors shaping economic growth are truly numerous and vary greatly across countries and over time. Moreover, these factors interact with each other in multifaceted ways, making every country's situation at each point in time by and large specific. This fact has very important implications for the ways in which research on growth needs to be conducted and for the policy implications for each case. Most importantly, it implies that the causes of stagnation and growth are ultimately situation-specific and must be understood locally. Furthermore, the actions needed to enhance growth must also be assessed and applied at the local level by policymakers who are intimately familiar with the situation.

The situation-specificity discussed above does not mean that no generalizations can be made and there is no role for general frameworks for understanding growth. Indeed, the framework proposed in this paper and the illustration of its use for analyzing major issues of growth in MENA suggest that there are flexible perspectives that can help organize thinking about economic development at general levels. Moreover, such approaches can shed light on why conditions become specific and which lessons from other cases can be transferred to others and which ones are not applicable elsewhere.

The proposed framework and its emphasis on incomplete contracting due to complexity also highlight the importance of carrying out in-depth case studies for understanding growth in specific

context while keeping in mind the lessons of the underlying economic theory. Another important general implication is that solutions to growth problems need to be in the end formulated and implemented at the local level by people who are intimately familiar with the situation at hand and, at the same time, have a good grasp of the available theoretical frameworks and empirical results.

While the incomplete contracting framework proposed here is fairly general, it has basic differences with the earlier approaches to the political economy of growth. Perhaps the most important feature of the framework is that it goes beyond the simple claims that powerful interest groups have been blocking reform. Furthermore, it offers ideas about why interest groups and politicians may not find ways to adopt more efficient policies that yield larger surpluses for themselves. In particular, in the case of MENA, the framework shows that the interactions among the politicians, different interest groups, and the public are far more intricate than the image of authoritarian governments forcing self-serving bad policies on the society. Rather, it may be the need for maintaining public support in the absence of a complete social contract that leads politicians to opt for inefficient policies. This further implies that although some of the institutions or policies one finds in the region may not be desirable from a long run perspective, under the circumstances of the short and medium run they may be better than feasible alternatives. However, change will be necessary as the underlying problems are better understood and addressed. In fact, there are already some institutions and policies that have better substitutes if the existing political economy knowledge is better disseminated among the politicians and the public.

Future research on the political economy of growth must proceed in a number of directions. To begin with, there is a need for more detailed case studies to explore the roots of failures to improve policies in specific circumstances. Second, there are many details of interactions among political actors that need to be explored theoretically and empirically, especially in the context of non-democratic political systems. This should particularly include studies of how the political structure shapes economic policies and how in turn economic outcomes affect the contracting capability of the political economy actors. Finally, there is a great need for documenting and quantifying institutional details and their dynamics in MENA, especially in ways that would be comparable across countries. This would provide better opportunities for testing hypotheses and digging deeper into the causes of growth and stagnation.

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Table A1
Variable Definitions for Table 4

The variables are defined and measured according to the following criteria:

	Government Intervention and Public Ownership	Trade Policy	
Score	Level of Government Intervention in the Economy:	Average Tariff Rate	Non-Tariff Barriers
1	*Very Low*: Less than 10 percent of GDP; virtually no government-owned enterprises.	< 4%	Very Low
2	*Low*: 11 percent to 25 percent of GDP; a few government-owned enterprises, like the postal service; aggressive privatization program in place.	5-9%	Low
3	*Moderate*: 26 percent to 35 percent of GDP; several government-owned enterprises like telecommunications, some banks, and energy production; stalled or limited privatization program.	10-14%	Moderate
4	*High*: 36 percent to 45 percent of GDP; many government-owned enterprises like transportation, goods distributors, and manufacturing companies.	15-19%	High
5	*Very High*: 46 percent or more of GDP; mostly government-owned industries; few private companies.	> 20%	Very High

Source: The Heritage Foundation website, *Index of Economic Freedom*.