Economic Development in the Arab Region: A Tale of Oil and Politics

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Abstract

This chapter reviews the development experience of the Arab countries since World War II, arguing that extractive economic and political institutions are the primary cause of the current state of underdevelopment in the region. While macroeconomic mismanagement and oil abundance are important determinants of performance, these factors are shaped primarily by the prevailing political institutions, which predate the discovery of oil. In the oil-poor Arab countries, limited progress is attributed to an authoritarian bargain in which the rulers offered economic benefits to the poor and the middle class in exchange for political acquiescence.
Finally, the chapter concludes by speculating about whether the recent Arab revolts will spread to the rest of the region and whether or not these revolts will be remembered in the future as a critical juncture toward more inclusive institutions and shared progress. It does not offer a conclusive answer, but suggests that early indications are positive.

**Keywords:** Middle East, Arab Spring, economic development, institutions, oil curse, authoritarian bargain, modernization
Introduction

The experience of the Arab countries offers a rich experiment for a study of the evolution of thinking on international development. Admittedly, the region shares many of the characteristics of other parts of the developing world; hence its study can only provide supporting evidence to what may be observed elsewhere. However, because the modern history of Arab countries is also defined by oil and most countries in the region are ruled by non-democratic regimes in an increasingly democratic world, its study offers a distinct opportunity to review the literature related to the oil curse and the influence of politics on development.

We start from the observation that the Arab countries today are not considered developed by international standards. Furthermore, they are not converging toward the standard of living in advanced or even successful emerging countries. The main question we address in this chapter is why.
Explanations of underdevelopment vary and have evolved over time. We do not intend to review this vast literature here, but would like to single out three broad explanations. The first attributes underdevelopment to the failure of governments to provide the necessary conditions for markets to function well and the Schumpeterian creative destruction to flourish. A recent vintage of this view is the Washington Consensus, which argues fundamentally that higher economic growth requires reducing market distortions, increasing competitive pressure, getting rid of ill-designed selective interventions, and reducing state domination of economic activities. In natural resource-rich countries, this approach would emphasize smoothing out consumption and savings over time, safeguarding against volatility and avoiding the Dutch disease.

Other explanations beyond economics have also been advanced, blaming underdevelopment on culture and/or geography. According to Max Weber, development in Europe benefited from the Protestant work ethic. By implication, other cultures, including the Islamic culture, may not be compatible with the accumulation of wealth. As for geography, Collier (2007) has argued in the context of Africa that landlocked countries tend to be underdeveloped. Both arguments could be interpreted to suggest that some countries are destined to remain underdeveloped because it is difficult to change culture or geography within a reasonable period of time, if ever.
Finally, the last few decades have seen the rise of institutions as a critical factor in underdevelopment (North 1991). This argument has recently been elaborated by Acemoglu and Robinson (2012), who demonstrate convincingly, drawing on centuries of history and a compelling framework, how political (and economic) institutions influence the fortune of nations. If political institutions are inclusive of most citizens, they tend to produce rules of the game that foster economic growth and shared prosperity. In contrast, extractive institutions have the opposite effects, even in the presence of temporary spurts of economic growth. Institutions are path dependent, but they can change over time at what are called “critical junctures.”

In exploring the relevance of these explanations to the Arab world, we argue that economic policies, culture, and geography cannot fully account for the region’s poor performance. Since World War II, most Arab countries have adopted development strategies that mirror the evolution of development thinking. They share some cultural characteristics, at least in terms of religion, with more successful countries such as Turkey, Malaysia, and Indonesia; the region is centrally located geographically, and has ample access to multiple seas and oceans. The more relevant explanation seems to be the extractive nature of their institutions, which predate the discovery of oil. The interesting question now is whether or not the Arab Spring will be viewed
in the future as a critical juncture that put at least some countries in the region on a positive trajectory.

The rest of the chapter covers as many as twenty-two countries. Notwithstanding their common culture and geography, these countries are heterogeneous at least in terms of size (population and income) and natural resource endowment. Because of the central role of oil in economic development, we find it analytically useful to divide them into oil-rich and non-oil-rich countries. Admittedly, countries within each group are also heterogeneous in other ways and merit an in-depth historical analysis in their own right, but such an analysis is beyond the scope of this chapter.

The chapter is structured as follows: We begin by placing the Arab countries on the development ladder and assessing their track record in catching up with advanced countries. In the following section we explore how oil-rich countries managed their resources, how oil may have impacted their institutions, and how institutions may have shaped their utilization of oil revenues. Next, we focus on the oil-poor Arab countries, exploring their economic reform efforts and how these
were influenced by political institutions; we then briefly discuss the potential implications and possible trajectories of the Arab Spring. The final section offers some concluding remarks.

**The state of development in the Arab world**

In measuring development outcomes, attention was earlier given to such measures as economic growth, GDP per capita, and to a lesser extent poverty and income distribution. In the early 1990s, the United Nations Development Programme (UNDP) championed a measure of well-being that relies on human development, which is a composite index of life expectancy, educational attainment, and income. More recently, increasing attention has been given to other measures such as inequality of opportunity, environmental sustainability, political voice, human rights, and even happiness.

Clearly not all of these concepts are easy to measure, nor are the data to measure them readily available in the Arab countries. However, available indicators unambiguously support the assertion that Arab countries are not among the most advanced regions in the world, nor are they likely to catch up in the near future.
Per capita income and income convergence

At a growth rate of 1.7 percent per annum, it took the region from 1973 to 2010 to double GDP per capita. Over time, the region’s GDP per capita relative to that of the OECD declined from fifteen percent in 1980 to nine percent in 2002 (Figure 44.1). In contrast, East Asian countries, whose GDP per capita was similar to that of the Arab countries in the mid-1970s, made substantial progress: in 2010, average per capita income in East Asia was 18.5 percent of the OECD average, up from fifteen percent in 1980. Some countries, like South Korea, did even better, reaching fifty-eight percent of the OECD’s GDP per capita in 2010, up from thirteen percent in 1960. The Arab countries also fell behind Latin America and were only ahead of sub-Saharan Africa.
Within the region, the oil-rich economies exhibit a low per capita growth/high volatility pattern. The oil-poor Arab countries did better, averaging 2.5 percent per capita GDP growth during the period 1961–2010, compared with only 1.4 percent during the same period for the oil-rich economies. Volatility of economic growth (measured by the ratio of standard deviation of growth over the mean) was also higher in oil-rich countries because of the adverse effects of volatile terms of trade between 1970 and 2007, which offset the positive impact of commodity booms (Cavalcanti, Mohaddes, and Raissi 2012).
In terms of catching up, oil-rich economies show alarming trends. In 1975, average per capita income in the member countries of the Gulf Cooperation Council (GCC)—namely, Saudi Arabia, Kuwait, Qatar, the United Arab Emirates, Oman, and Bahrain—was almost the same as in the OECD; in 2010 it was slightly less than one-third. Correspondingly, the trend is more favorable for the oil-poor economies, although the average per capita income never exceeded 12 percent of the OECD average.

Poverty and Inequality

Notwithstanding the modest per capita growth rates since 1961, poverty in the region is relatively low and has in fact declined over time. Using the US$1.25 poverty line (in 2005 purchasing power parity/PPP), poverty in the region is only around 4 percent, which is less than one-fifth of the average poverty rate for developing countries and close to the figure for the much richer Latin American region. Based on the US$2 a day higher threshold, poverty in the Arab countries is still less than half of the average for developing countries. The rate declined in 2008 to 2.7 percent (Abu-Ismail, Taleb, and Ramadan 2011).
Turning to inequality, Bibi and Nabli (2010) survey the literature on the Arab world and conclude, on the basis of average Gini coefficients, that the region is a “medium inequality” region. Arab countries fare better than Latin America (where inequality is the highest) and sub-Saharan Africa, but are more unequal than East Asia, South Asia, and (by far) Europe and Central Asia.

The above conclusion takes the Gini coefficients at face value. However, their accuracy has been called into question on the grounds of limitations of coverage and data shortcomings. It is therefore important to look at other measures of inequality, such as inequality of opportunity, for example in terms of access to education and health care. In this context, Assaad et al. (2011) show that the Arab world faces unequal opportunities in child health because of circumstances that lie beyond the control of families.
**Human development and unemployment**

By various measures of human development, the Arab countries fall behind advanced countries as well as developing regions except sub-Saharan Africa. As shown in Table 44.1, this observation holds whether we consider enrollment in primary or secondary schools, life expectancy, or infant mortality rates. Fertility rates also remain much higher than elsewhere, averaging 3.3 births per woman.

**Table 1: Human and social development indicators, 2009**

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Arab countries</th>
<th>East Asia</th>
<th>Europe and Central Asia</th>
<th>Latin America</th>
<th>Sub-Saharan Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>School enrollment, primary (% gross)</td>
<td>97.7</td>
<td>110.5</td>
<td>101.6</td>
<td>116.7</td>
<td>99.9</td>
</tr>
<tr>
<td>School enrollment, secondary (% gross)</td>
<td>73.6</td>
<td>77.8</td>
<td>96.6</td>
<td>89.6</td>
<td>36.0</td>
</tr>
<tr>
<td>Life expectancy at birth, total (years)</td>
<td>69.9</td>
<td>73.0</td>
<td>75.5</td>
<td>73.9</td>
<td>53.8</td>
</tr>
<tr>
<td>Fertility rate, total (births per woman)</td>
<td>3.3</td>
<td>1.8</td>
<td>1.7</td>
<td>2.3</td>
<td>5.0</td>
</tr>
<tr>
<td>Mortality rate, infant (per 1,000 live births)</td>
<td>37.2</td>
<td>18.8</td>
<td>11.8</td>
<td>18.1</td>
<td>76.4</td>
</tr>
</tbody>
</table>

*Source: World Bank Development Indicators*
Over time, human development indicators improved significantly in the region. Between the 1960s and 1990s, access to free education and primary health care services was broadened, especially in Egypt, Tunisia, Sudan, and Algeria. By 2009, close to 100 percent of the children in the region were enrolled in primary school, and secondary school enrollment went up from 20 to 74 percent of the relevant age cohort. Life expectancy went up by some 25 years, fertility rates declined by 4 births per woman, and infant mortality rates dropped by more than 100 per thousand live births.

Notwithstanding this progress, the increased supply of skilled labor was not put to productive use. At the same time, unemployment persisted at around 9.3 percent and was concentrated among the young and educated. The gender bias is also evident, with unemployment rates for women at about 18 percent compared to 8 percent for men. These rates are almost double the corresponding rates in Latin American and the Caribbean (LAC) and Europe.

Within the region, unemployment in the oil-rich Arab countries is low at around 4 percent, with the notable exceptions of Yemen and Algeria. The GCC labor markets rely on foreign labor to the extent that the proportion of the domestic work force to total labor force is invariably under one-half (Assaad and Ramadan 2008). Most employed nationals work for the government. As for
non-oil-rich economies, unemployment rates tend to be higher (approximately 11 percent), especially in Tunisia and Jordan.

Over time, the oil boom in the 1970s led to a decline in unemployment in resource-rich countries, which has remained low since then. In the resource-poor economies, however, unemployment has been on the rise. In Egypt, from the 1960s to the 1990s, under the influence of populist policies, all graduates were assured employment in government. However, Assaad and Ramadan (2008) argue that the policy of hiring at higher than market wages encouraged new entrants into the labor market to queue for years for a public sector job. They further argue that the education systems were adapted to meet the strong demand for credentials that allow entry into the public sector, to the detriment of the skills required in a private-sector economy. This observation may also apply to other countries in the region.

In sum, then, the state of development in the Arab world, oil-rich or not, is not satisfactory. To be sure, poverty in the region is relatively low, by available evidence inequality is moderate, and notable progress has been made in the area of human development, including enrollment in education, life expectancy, and fertility and infant mortality rates. However, economic per capita growth has remained modest and volatile, especially in oil-rich countries. Inequality of
opportunity and possibly wealth is high and employment opportunities are meager relative to a growing labor force. The situation is particularly acute with respect to youth and women. So what went wrong?

**Economics and politics in oil-rich Arab countries**

For a group of eight Arab countries, the share of oil rents to GDP, excluding other hydrocarbon sectors, fluctuated around 38 percent between 1974 and 2009 (Figure 2). The percentage is much higher for Iraq (60 percent), Kuwait (48.5 percent), Saudi Arabia (44 percent), and Oman (42 percent). Figure 44.2 also indicates that their economic growth mirrors oil revenues. This observation suggests that these economies are defined largely by oil booms and busts. And given that these economies have not been successful in joining the group of advanced countries, it is tempting to attribute their failure to an oil curse.
Figure 2. Oil rent and GDP per capita in oil-rich Arab countries, 1974-2009.

Source: World Bank Development Indicators

This interpretation contradicts the early literature, which considered natural resource abundance a source of economic development because of its ability to generate income, savings, and investment that would sustain future output growth and enable governments to provide public goods (Nurkse 1953; Rostow 1960). It is consistent, however, with subsequent country experiences, which showed that resource abundance is associated with poor development outcomes. This curse has been attributed to several causes, the most important of which are:
(1) the Dutch disease and low savings, (2) “political resource curse,” and (3) “extractive institutions.” This section explores these transmission mechanisms.

**The Dutch disease, export diversification, and savings**

One of the potential channels of the resource curse is the Dutch disease. Corden (1984) provides a theoretical framework in which the appreciation of the real exchange rate due to increased resource revenues spent on non-tradable goods leads to a decline in the competitiveness of the non-resource sector, or skews the composition of exports away from manufacturing exports (Sachs and Warner 1995).

In some oil-rich Arab countries there is evidence of real exchange rate appreciation between 1975 and 2005 (Diop, Marotta, and de Melo 2012). This misalignment has undermined the competitiveness of non-oil exports, especially manufacturing. According to Nabli (2007), the exchange rate overvaluation reduced manufacturing exports by 18 percent (as a percentage of GDP per year) between 1970 and 1999.
Compared to other regions, the Arab region’s non-oil merchandise exports relative to total exports are much lower (Galal and Selim 2012). This suggests that countries of the region were unable to diversify their economies, which is problematic given that oil is not a renewable resource. This is a reminder of the fear once expressed by King Faisal of Saudi Arabia, who said (in an interview with his oil minister, Sheikh Yamani), “In one generation we went from riding camels to riding Cadillacs. The way we are wasting money, I fear the next generation will be riding camels again.”

Turning to savings, because oil revenues are subject to depletion, rational governments need to smooth out consumption well beyond the period of peak resource revenues and stock precautionary savings to ensure inter-generational equity. They also need to gradually transform their oil wealth into assets whose income stream would sustain a stable level of government spending. This literature advises resource-dependent governments to develop counter-cyclical fiscal policies, resisting the temptation to overspend during oil booms.

The empirical evidence shows the opposite: fiscal policy in commodity-exporting countries in general is pro-cyclical. Arab resource-rich countries are no exception (Abdih, Lopez-Murphy,
and Sahay 2010). More generally, there is some concern related to the way governments are engaged in the depletion of natural resources and the minimal concern they show for the environment (Galal and Selim 2012). Finally, the high volatility of oil revenues was costly in terms of economic growth in oil-rich Arab countries (Cavalcanti, Mohaddes, and Raissi 2012).

All this is to say that macroeconomic management in oil-rich Arab countries leaves much to be desired.

**The political resource curse**

Turning to the impact of oil on politics, modernization theory predicts that rising income is associated with democratization. However, Ross (2001) argues that this prediction may not hold in oil-rich countries. He identifies three mechanisms through which oil revenues enable government to maintain their authoritarian rule. First, income from natural wealth is said to breed a “rentier state.” Second, it enables governments to “repress” the population by acquiring the means to do so. Finally, oil revenues are not always associated with bringing about the cultural and social values that promote democracy and “modernization.” A fourth mechanism, not
mentioned by Ross, is that oil wealth could sustain autocratic regimes by insulating them from the pressure from the West to democratize.

There is a large body of literature that supports the claim that oil hurts democratization (Ross 2001), recently disputed by Haber and Menaldo (2011). Studies focusing on the Arab region (e.g., Elbadawi and Makdisi 2011) reach a similar conclusion.

The logic behind the assertion that oil sustains authoritarianism rests on several grounds. The first is that oil revenues breed “rentier states,” a proposition made by El Beblawi and Luciani (1987). If governments derive large sums of money from oil, they can afford to apply low tax rates and reduce the pressure for more accountability. The figures provided in Table 44.2 point out that most oil-rich Arab governments derive a large fraction—in fact, more than two-thirds—of their total revenues from oil. As a result, tax revenues as a percentage of total revenue are less than 6 percent in all countries except Algeria. Oil rents thus break the link between taxation and representation.
Table 2. Government revenues and expenditures in selected Arab countries, averages 2003-2010, percent

<table>
<thead>
<tr>
<th></th>
<th>Algeria</th>
<th>Kuwait</th>
<th>Oman</th>
<th>Qatar</th>
<th>Saudi Arabia</th>
<th>UAE</th>
</tr>
</thead>
<tbody>
<tr>
<td>(% of total revenue)</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Hydrocarbon revenue</td>
<td>72.5</td>
<td>76.3</td>
<td>77.4</td>
<td>62.0</td>
<td>86.8</td>
<td>76.2</td>
</tr>
<tr>
<td>Non-Hydrocarbon revenue</td>
<td>27.5</td>
<td>23.7</td>
<td>22.6</td>
<td>38.0</td>
<td>13.2</td>
<td>23.8</td>
</tr>
<tr>
<td>Tax revenue</td>
<td>24.2</td>
<td>1.7</td>
<td>6.9</td>
<td>5.4</td>
<td>Na</td>
<td>2.6</td>
</tr>
<tr>
<td>(% of total expenditure)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current expenditure</td>
<td>59.0</td>
<td>87.6</td>
<td>66.5</td>
<td>71.5</td>
<td>78.3</td>
<td>75.3</td>
</tr>
<tr>
<td>Wages and salaries</td>
<td>22.5</td>
<td>29.2</td>
<td>21.6</td>
<td>18.9</td>
<td>30.2</td>
<td>13.2</td>
</tr>
<tr>
<td>Subsidies and social benefits</td>
<td>26.8</td>
<td>35.4</td>
<td>9.0</td>
<td>13.9</td>
<td>4.2</td>
<td>16.7</td>
</tr>
<tr>
<td>Defense and security</td>
<td>9.5</td>
<td>21.4</td>
<td>29.5</td>
<td>9.8</td>
<td>27.3</td>
<td>22.5</td>
</tr>
</tbody>
</table>

Notes: Due to some unavailability for some variables, data are included until 2009 only.

Source: Galal and Selim (2012)

Large oil rents also enable Arab governments through public expenditure to engage in patronage and appeasing of citizens. These expenditures tend to rise sharply at times of threats to the regime. For evidence, between 2003 and 2010, subsidies and transfers in the countries listed in Table 44.2 range between 14 and 35 percent of total expenditures. Beyond explicit subsidies (electricity, water, and fuel) and transfers, citizens in the GCC receive free health care, education, and social security. Perhaps more important, the most frequently used mechanism for patronage is the provision of well-remunerated and stable public jobs to nationals. The
average salary of Saudi civil servants is three times the average wage for Saudis in the private sector (Hodson 2011).

When political unrest mounted in 2011, oil rents were used by the GCC governments to calm down citizens. Kuwait and Bahrain responded by giving out cash, Bahrain and Oman provided public-sector jobs, and Saudi Arabia and Oman raised workers’ wages and benefits. Clearly, while these transfers increase citizens’ welfare, they are also politically motivated.

Turning to the “repression” channel, it is evident that political demonstrations are a rarity in the Gulf countries. Is this a reflection of satisfaction or repression? Recent events in Oman and Bahrain are instructive. Encouraged by neighboring countries’ success in toppling their autocratic rulers, pro-democracy protests took place in these two countries in early 2011. In response, governments resorted to the security apparatus. Moreover, Bellin (2004) adds that these regimes often maintain strong personal linkages with the coercive apparatus by appointing family members to key branches of the military and security forces. In Algeria, the military is very strong, to the point that Mohammad Harbi was quoted as saying, “Every state has an army but in Algeria the army has a state.”
With respect to the “modernization effect,” certain occupational specializations, urbanization, and better education are supposed to accompany economic development, and these changes should produce a population better able to organize and bargain for greater political demands (Inglehart 1997). The problem is that oil money could be used to at least slow down these social changes. Many of these features characterize oil-rich Arab countries. Farsoun (1988) argues that those who benefited from social changes were those related to the ruling family. Other intellectuals were absorbed in unproductive government bureaucracies.

Finally there is the “external” factor. The abundance of oil made the region of geopolitical strategic importance to the West, motivated as it was by self-interest. This reality made these regimes less vulnerable to external pressure to adopt political openness (Diamond 2010). Further, Bellin (2004) suggests that the West has supported the regimes in Saudi Arabia and Algeria because of the belief (perhaps mistaken, as she says) that their stability would assure a regular supply of oil and containment of an Islamist threat.
In the above section, the argument ran from oil to democracy. However, the inverse causality—from political institutions to oil—is even more compelling. In this scenario, rulers do not face significant restraints on their power and enjoy ample access to rents, which they use primarily for private rather than public good. Accordingly, oil wealth is not a curse in its own right, its management is. The political resource curse is a symptom; extractive institutions are the primary cause.

This argument has been developed by Acemoglu and Robinson (2012). They attribute the failure of nations to the concentration of power in the hands of a narrow elite who make the rules in their own favor at the expense of the majority. These rules tend to create barriers to entry, provide special concessions, limit opportunities, and discourage entrepreneurship and innovation.

Focusing on oil countries, Robinson, Torvik, and Verdier (2006) built a theoretical model explaining how institutions impact the rate of extraction of oil, how oil booms impact the
extraction path, and how abundance of revenues affects the behavior of politicians. They conclude that:

The overall impact of resource booms on the economy depends critically on institutions since these determine the extent to which political incentives map into policy outcomes. Countries with institutions that promote accountability and state competence will benefit from resource booms since these institutions ameliorate the perverse political incentives that such booms create. Countries without such institutions however may suffer from a resource curse. (Robinson, Torvik, and Verdier 2006)

These predictions are supported by several studies, the key conclusion of which is that the oil curse is not destiny and depends on institutions (Mehlum, Moene, and Torvik 2006). Elbadawi and Soto (2012) also show that resource-rich economies with a high degree of inclusiveness (a measure of democracy) and strong political checks and balances turn the resource curse into a blessing.
It is of course possible that oil abundance can and does provide an opportunity to weaken institutions and increase corruption. And indeed there is some evidence to that effect (Leite and Weidman 1999). However, this evidence does not negate the view that institutions are the primary driving force of how oil impacts development. These institutions often predate the discovery of oil, and they tend to linger on.

Currently, institutions in oil-rich Arab countries seem to carry the features of extractive institutions described above. In 2011, out of the 115 electoral democracies in the world, 87 were considered “free,” of which none is an Arab oil-rich economy (Freedom House 2012). Only one country, Kuwait, is considered partly free. This pattern worsened between 2000 and 2010, especially with respect to measures of voice and accountability, political stability, and corruption (Figure 44.3). Areas of observed improvements (government effectiveness and regulatory quality) relate to private sector’s interest, not the population at large.
Historically, these institutions are not the product of oil; they predate the discovery of oil. In tracing their roots, Atallah (2011) offers very useful insights. For Oman, Bahrain, and Qatar, their geographic proximity to India, where Britain’s colonial interests lay in the early twentieth century, shifted the balance of power in favor of the local rulers who were loyal to the British in return for military and fiscal support. Enjoying external rents, the rulers could ignore demands for political participation. In these countries, the discovery of oil (or natural gas) merely replaced the subsidies from the British.

Countries that were geographically distant from Britain placed more emphasis on coalition-building with internal players, either religious or economic groups. In Saudi Arabia, the
ruling Al Saud family built an alliance with the religious police, commonly called the mutaween. In return for support, the ruling family gave the mutaween a platform through which to promote their interpretation of Islam. The discovery of oil did not change this coalition and may in fact have strengthened it.

In Kuwait, the setup was different and more conducive to political representation. Atallah (2011) explains that in the absence of oil, the rulers depended on the merchants for revenues, which pushed them to concede some political power in return for fiscal backing. An assembly was created as early as 1938, even though it was dissolved soon afterward. The discovery of oil provided the ruling elite with enough financial leverage to weaken the link with the merchants. However, the strength of this class enabled them to negotiate giving up some political rights in return for a share in the rents.

Over time, all rulers in the region gradually expanded their patronage networks to include friends and family. Saudi Arabia and Kuwait “institutionalized family members into government positions, partly to give them a stake in the system and partly to monitor them” (Atallah 2011). An elite of “rent-seeking pseudo-entrepreneurs” became intertwined in the
state capture of resource rents (Dauderstädt and Schildberg 2006). And according to Nabli (2007), governments in these countries failed to create a dynamic and competitive private sector; rather, they extended favors to a privileged group, which over time has become the guardian of the status quo.

In sum, the modest progress made by oil-rich Arab countries cannot be blamed solely on the way the economy was managed or on the abundance of oil. Extractive institutions, which predate the discovery of oil, seem to be the true culprits.

**Economics and politics in oil-poor Arab countries**

The oil-poor Arab countries share many of the characteristics of other developing countries. Furthermore, most of them adopted the development strategies that mirrored the evolution of development thinking. However, more than half a century later, none of these countries was able to join the group of successful emerging countries. In the remainder of this section, we review their reform efforts and explore the roots and nature of the political bargain the ruling elite struck with the population.
**Reform efforts**

Just like many other developing countries, oil-poor Arab countries started their attempt to develop after independence in the post-World War II era by employing an import substitution strategy (ISS). The state played the leading role in the development process to compensate for incidents of market and coordination failures. Countries like Egypt, Tunisia, Jordan, and Morocco pursued industrialization through large public-sector projects, protection, and central planning. They also committed themselves to a grand welfare agenda, including land reform, free access to social services (health and education), and employment guarantee schemes.

This strategy had strong intellectual underpinnings. Keynes gave the state a good name in the context of dealing with the great depression in the 1930s. Well-known development economists like Rosenstein-Rodan and Lewis provided powerful arguments for state leadership of development, and pioneers of the structuralist approach (e.g., Raúl Prebisch) argued that underdevelopment in the south was due to an exploitative relationship between the rich countries (the center) and developing countries (the periphery).
In its early phases the import substitution policy produced positive results, particularly in terms of economic diversification, inclusion of marginalized groups, and higher levels of employment. However, the limitations of this development model and the drying up of resources to finance social programs led to a shift toward market forces and private-sector initiatives in the 1980s and ‘90s. The shift in countries like Tunisia, Egypt, Morocco, and Jordan was supported by the international financial institutions (IFIs).

The “Washington Consensus” agenda was credited with bringing about macroeconomic stability, higher economic growth, and in some cases poverty reduction. However, these achievements were associated with corruption and increased concentration of power and wealth in a few hands, which may have contributed to the recent wave of upheavals in the region.

**The underlying social contract**

So what went wrong? Was poor economic performance due to the wrong kind, mix, or sequence of recommended policies? Or was it due to the adoption by the ruling elite of policies that
supported its persistence in power? We argue it is the latter, without entirely dismissing the former view.

In attempting to understand the nature of the social contract that led the ruling elite to behave the way it did, some analysts developed what is now called an authoritarian bargain model (ABM) (Desai, Olofsgård, and Yousef 2009; Yousef 2004; and King 2009). In this model, autocratic leaders provided their citizens some economic benefits (welfare and public employment programs) in return for consent to relinquish political rights.

The ABM was defended by the leaders of nationalist movements as necessary to pursue the larger cause of rapid industrialization, social justice, and greater equality. Anderson (1987) argues that in reality, populist measures aimed to inhibit the development of an independent bourgeoisie that might have threatened political stability. Along the same lines, King (2009) argues that the undeclared aim was to build new constituencies in support of the regime instead of the bourgeoisie that consisted of rich landowners who were seen as the main ally of colonial powers. Thus, Arab socialism favored workers, peasants, and the lower middle classes generally, including the administrative elite and bureaucrats in the public sector. These preferences were often expressed explicitly in constitutions, laws, and public policies. In return for these generous
benefits, governments expected unconditional political support from the masses. They also imposed control over organized labor and other political and intellectual movements: in Egypt, for example, strikes were forbidden. When necessary, the state became sharply coercive and repressive.

The ABM came under strain in the 1980s and '90s, in part because of the decline in oil prices (and associated remittances to oil-poor countries) and the structural reforms carried out in Egypt, Jordan, Morocco, and Tunisia under the umbrella of the IMF and the World Bank. The ABM survived but not without consequences. As governments were reluctant to curtail many of the interventionist–redistributive policies inherited from the 1960s, they were compelled to proceed with some political liberalization. In countries like Egypt, Jordan, Morocco, and to a much lesser extent Tunisia, the autocrats gave opposition political parties more political space, expanded civil liberties, and increased the participation of civil society (King 2009). These experiments fell short of democratization, and merely provided a façade of multi-party politics.

Meanwhile, economic reforms, particularly privatization, generated new rents and contributed to the formation of a new coalition composed of a rent-seeking bourgeoisie, instead of the old 1960s coalition of workers, peasants, and the middle class (King 2009). This new group
contributed to the transformation of populist authoritarian regimes into elitist crony capitalist forms of authoritarian rule.

One piece of supporting evidence for the above analysis is the set of indicators provided in Figure 44.4, which show that all governance indicators in the oil-rich Arab countries were negative between 2000 and 2010. Moreover, these indicators have in fact deteriorated over time. This observation applies to voice and accountability, political stability, the rule of law, and control of corruption. Where some improvements were made (regarding the quality of regulation and government effectiveness), it can be argued that they were adopted because they served the private sector, which was seen as supportive of the regime.

**Figure 4. Governance indicators in oil-poor Arab countries, in 2000 and 2010**

Note: Values vary from -2.5 (bad governance) to 2.5 (good governance)
The role of the West in this process was very similar to its role in the oil-rich countries. In the 1960s, the West supported autocratic leaders in oil-poor countries to limit the influence of communism. Later, it turned a blind eye to autocratic regimes in order to maintain regional stability, contain a perceived threat of Islamists, and protect leaders with a moderate position in the Arab-Israeli conflict.

The roots of institutional imperfections

Notwithstanding major shifts in the political life of many countries in the region in the last century or so, the roots of extractive institutions can be traced to earlier periods. During the Ottoman occupation, some two hundred years ago, the Sultan himself was “accountable to few and sharing power with none,” according to Acemoglu and Robinson (2012). He created a system in occupied territories where the land was the property of the state, commerce was under state control, and the economy was strictly regulated by monopolies. The Ottomans resisted serious institutional reforms in their provinces as their interests were narrowly confined to
control and taxation. They opportunistically relied on a small group of allies, like the Mamluks in Egypt or local governors in Syria, who had enough power and authority to collect land taxes in return for a regular salary or a portion of land for their own use. In turn, these agents allied themselves with small but loyal local networks through a combination of “threats, patronage and largesse.” In time, both the agents and their allies accumulated significant personal wealth and retained large parts of revenues to maintain force to deter potential rivals (Owen 1981).

When the European colonialists replaced the Ottoman Empire, they tolerated some political and civic representation, allowing a vibrant civil society to emerge, including political parties, trade unions, and professional associations. However, power continued to be concentrated in a few hands, mainly those of feudalists and emerging industrialists who were the main allies of the colonial powers (Owen 1981; Yousef 2004; Anderson 1987). This institutional setup, along with the rise of anti-colonial/nationalist movements, paved the way for the 1960s populist social contract, as discussed above.

In short, then, oil-poor Arab countries did follow evolving development strategies after independence. While some progress was made, their political (and economic) institutions were not conducive to achieving sustainable development. The form of extractive institutions changed
over time, but their essence remained the same. The Arab Spring movements appear to be a potential disruption of this trend.

The Arab Spring

If there is one thing the 2011 uprisings made clear, it is that governments in the Arab Spring countries failed to provide a satisfactory life for the majority of their citizens. The social contract, which had survived economic hardships and waves of democratization the world over, finally broke. Surprisingly, it first broke in Tunisia and Egypt, the two countries in the region that were hailed right before the uprisings for achieving high levels of economic growth. The youth who took the lead in these uprisings were educated, middle class, and well versed in social media. In both countries, they demanded freedom, dignity, and social justice—precisely the values that previous governments had failed to achieve. Intuitively, the revolutionaries came to the conclusion that it was bad politics, not bad economics, that produced undesirable outcomes.

In attempting to explain what happened in a rational framework, Diwan (2012) expands the ABM to include three players: the rich (the autocratic coalition who benefited from the 1990s
liberalization policies), the middle class, and the poor. In a game theoretic setting, he shows that the middle class, traditionally allied with the autocrats and supported the ruling regime, chose to tip their support away from the autocrats toward democratic transition. The rationale for their behavior is that they were no longer the main beneficiaries of the social contract. They were also facing increased repression and abuse of human rights. At the same time, they saw that crony capitalism was flourishing and driving up inequality.

Two important questions are now on the minds of many in the region: Will these revolutions spread beyond the current set of countries, and will these changes constitute a step toward building inclusive institutions in the Arab Spring countries? On contagion, it is remarkable how fast the fire caught across countries in the region. Within a year, the revolutions moved from Tunisia and Egypt to Yemen, Libya, and Syria. The potential for these uprisings to spread to oil-rich countries at a significant scale in the short run may not be high, in part because of oil rents and in part because many of the rulers derive their legitimacy from religious or tribal associations. Nevertheless, it is interesting to note that the kings of both Morocco and Jordan are trying to be ahead of the curve by adopting some institutional reforms to impose more checks and balances on their relationships with their citizens.
Will these uprisings constitute “critical junctures” toward more inclusive institutions? This is a difficult question to answer. For a clue, Acemoglu and Robinson seem to be advancing two preconditions: (1) the existence of a centralized state, and (2) signs that the institutional changes are allowing political competition, participation, and restraints on the ruling elite. Clearly it is not easy for a country like Somalia to have inclusive political institutions under the current fragmentation of power and low order. And it is equally difficult to see how North Korea could make its institutions more inclusive in the short run, given the tight grip of the communist party on political life. For countries in between, alternative scenarios are possible, fully recognizing that the process is likely to be non-linear and may take years to bear fruit.

Applying the above framework to the Arab Spring countries, Tunisia and Egypt seem to have the potential to turn their uprisings into a move toward inclusive institutions. Both countries have well-established centralized states with well-recognized boundaries, homogenous populations, and no history of significant internal conflicts, and in a relatively short period of time, slightly over one year, they took steps toward drafting a modern constitution with checks and balances, and have been able to hold free parliamentary elections. In Egypt, for the first time ever, multiple presidential candidates competed for the job, on platforms that were widely discussed. Emerging political powers are accepting court rules as a mechanism for resolving conflicts.
The above outcome is uncertain, however. Institutions persist over time and are path dependent. Pre-revolution elites enjoy some power and are likely to exercise this power to foster institutions that would sustain their interests. The rise of the Islamists adds a new twist that has yet to play out. Whatever the outcome may be, the strong showing of a large segment of the population demanding freedom, justice, and dignity means that future institutions can only be more, not less, inclusive.

Conclusion

This chapter reviewed the development experience of the Arab countries since World War II in the context of the evolving thinking about economic development, oil abundance, and the nature and history of political institutions. It has been argued that limited development outcomes in the oil-rich countries can be traced much more directly to the nature of politics in these countries than to mismanagement of resources or the oil curse. On the contrary, the abundance of oil offers these countries an opportunity to make progress on the development front that was missed.
because of their extractive institutions. The claim that modernization will take hold as per capita income rises and urbanization and education spread seems illusionary.

The paradox is that over the past few decades, oil-poor Arab countries have performed better than oil-rich countries in terms of per capita growth rates. However, these countries were similarly held back by their exclusive political systems and the domination of authoritarian regimes that worked for the benefit of the few. The recent uprisings in some of these countries offer an opportunity to break with past regimes, but the outcome remains uncertain. The positive signs of adopting and implementing new election rules, the drafting of new constitutions with more checks and balances, and the rise to power of new political groups promise a brighter future, even if the process is likely to be protracted and non-linear.

The broader conclusion in terms of development thought is that the experience of the Arab countries is not dramatically different from that of other developing countries. However, this experience brings to the forefront the critical role that natural resource abundance and politics play in economic development.
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The Arab region refers to members of the League of Arab States, including Algeria, Bahrain, Comoros, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, the United Arab Emirates, and Yemen.

Of the 22 Arab countries, 11 account for 55 percent of global oil reserves.

Le Soir de Bruxelles, January 11, 2002.

A country is free where there is open political competition, a climate of respect for civil liberties, significant and independent civic life, and independent media.
References


