10 PAPERS IEMed.

TRANSITION ALL OVER?

LESSONS FROM THE EXPERIENCE OF THE POST-COMMUNIST COUNTRIES FOR THE COUNTRIES OF THE ARAB SPRING

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IEMed.
European Institute of the Mediterranean (IEMed.)

Consortium formed by:
Ministry of Foreign Affairs and Cooperation
Government of Catalonia
Barcelona City Council

PapersIEMed.
Published by the European Institute of the Mediterranean
Coordination: Javier Albarracín
Proof-reading: Neil Charlton
Layout: Núria Esparza
ISSN: 1999-7981
December 2011

Project funded by
the European Union

EUROMED

This publication has been produced with the assistance of the European Union. The contents of this publication are the sole responsibility of the authors and can in no way be taken to reflect the views of the European Union or the European Institute of the Mediterranean.

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Transition All Over? Lessons from the Experience of the Post-Communist Countries for the Countries of the Arab Spring

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Introduction

The Arab Spring marks a watershed event, a world irrevocably changed. The social contract governing the relationship between ruling classes and their populations has been shattered. This contract demanded, as well as promised, more than it could deliver; a popular acquiescence to an authoritarian regime – giving up freedom of speech and political activism – in exchange for a given level of living conditions, be it jobs, housing, education, or health provision. Deteriorating socioeconomic conditions and inequalities underscored irreparable flaws in such an arrangement and provided the dry wood set alight by the spark of events originating in Tunisia, and spreading through Egypt, Libya, and Syria. In the Middle East and North Africa, more than twenty-five percent of young people are unemployed or underemployed in low paying informal sector jobs. The challenges facing youth in particular have been widely reported during the coverage of the recent events: though many young people have been well-educated, there has been a profound lack of employment opportunities. Those hoping to create their own opportunities – by pursuing entrepreneurship through start-up businesses, etc. – have been stymied by poor economic governance institutions and policies, low rates of international trade and investment, and entrenched interests, which benefit from limiting economic competition and innovation.

The events have given hope to millions in the Middle East and North Africa (MENA) region of a politically more open, economically prosperous, and egalitarian future. To get there, however, the countries have to overcome several challenging obstacles. The democratization process needs to be consolidated and institutionalized, the economic structure needs to be modernized and opened up for competition, and an institutional framework that protects property rights, contract enforcement and equal business opportunities for all needs to be developed. This is a daunting task, and the experience of the so-called transition countries, the post-Communist countries in Central and Eastern Europe (CEE, includes the Baltic States) and the Commonwealth of Independent States (CIS, the former Soviet Union except for the Baltic States), shows that there are many challenges on the way, but also that progress is possible. The purpose of this paper is to discuss the transition experience, and the academic literature that emanated from it, and identify lessons relevant for understanding the challenges and opportunities reforming countries in the Arab world face.

The paper contains two main sections. The first section focuses on general themes in the experiences of the CEE and CIS countries. It opens up with an overview of the outcomes, emphasizing common features shared by almost all countries in the beginning of the transition, such as a drop in output, job destruction and structural change, but also the current divergence in terms of economic development, democratic consolidation and institutional maturity. After that, the discussion turns to explanations of the outcomes, in particular factors that can explain their current diversity. This will include subsections on the role of initial conditions, outside anchors (in particular the importance of the EU for the CEE countries, and Russia's influence over CIS countries), political stability and accountability, institutional reforms and economic reform strategies.

The second section focuses on a set of key insights derived from the previous section relevant for the current situation in the Mediterranean Arab countries. Given the role of initial conditions in the transition experience, we first offer some indicators on economic and political development and compare that to the situation in CEE and CIS countries 20 years ago. Obviously neither group is homogenous, but it is important to understand that most of the Arab countries have more in common with the CIS than the CEE countries, both in terms of economic development and structure, political institutions and experience with democracy (or rather lack thereof). After that follows sections on what we identify as key challenges the Arab countries are likely to face, and what the transition experience can tell us about what made those countries manage to overcome, or not, those challenges. A first section focuses on the challenges of democratic consolidation. A second section focuses on institutional reforms and credibility. The third section looks at the political economy aspect of reform design and sequencing. The final section discusses how to deal with the blessing or curse of natural resources, something that countries like Libya and Algeria have in common with countries such as Russia, Kazakhstan and Azerbaijan. If used well, natural resource revenues can be used to compensate losers from reforms and thereby make reforms politically more feasible, or to invest in an economic restructuring. Unfortunately, experience tells us that just as often the revenues become a source of conflict and corruption, and they can also slow the pace of democratic reforms and economic restructuring. Finally, we summarize our arguments in a concluding section, and offer some suggestions for what the international community needs to think about.

The Transition Experience of the CEE and CIS Countries

The purpose of this section is to offer a short and basic description of some of the main lessons from the experiences of the CEE and CIS countries. Obviously, this is a topic worthy of a book in its own, but in the context of this paper it mainly serves as a background to the next section in which we discuss what these lessons may imply for the Arab Mediterranean countries.[1]

In terms of outcomes, it is important to distinguish between the immediate effects of dismantling the old command economy, and the current situation.[2] All the CEE and CIS countries were hit by a substantial initial shock to the economy. The average size of the drop in output took most economists by surprise. With basically no theory for understanding a transition from a command economy to a market economy, the expectation was that improved incentives and a more efficient allocation of resources would unlock the potential of the existing human and physical capital, and that output and productivity would increase. Instead, output fell significantly in all countries during the first few years, though the size of the drop as well as the time needed for recovery has varied noticeably.[3] The profession thus underestimated the immediate distortions from the disorganization of patterns of trade, financial capital flows and hierarchies of intermediate input providers.

Despite the roughly similar early experiences, the current level of economic and political development varies dramatically across countries. The appendix includes a table with some group averages for a set of current economic and political indicators. As can be seen, all countries have grown since 1990, but substantially more so in Central Europe than in the trio of Russia, Ukraine and Belorussia. The differences are even more striking when looking at more political variables. The CEE countries are much less corrupt, have made much more progress on economic reforms and have much higher government effectiveness than the CIS countries. Inequality across the regional averages is quite even, but that masks a much higher level of inequality in Russia (a GINI of 42.3 in 2008).

So, how can the variation in outcomes illustrated above be explained? The literature has in particular focused on three sets of variables; initial conditions, political and institutional development, and the extent and modes of economic reforms. It should be emphasized, though, that there are many issues that are still controversial and for which there is no general consensus among scholars, such as the relative merits of a big bang approach vs. a gradualist approach to reform. It should also be noted that there are many methodological complications involved when trying to estimate causal effects, since many of the explanatory variables are endogenous. For instance, progress in implementing economic and institutional reforms may depend on initial conditions.

Initial Conditions

In Table 2 in the appendix we provide some data from 1990 on the income level, economic structure, school enrolment, life expectancy and inequality for the different country groupings. Obviously, there is quite a bit of variation, but there are a couple of noteworthy facts. Initial income was substantially higher in the Baltic countries, Poland, Czechoslovakia, Hungary and Slovenia, and substantially lower in the Asian republics of the former Soviet Union. On the other variables the differences are generally smaller. All groupings are over-industrialized and have high levels of school enrolment relative to expectations at that income level, and they all have very low levels of inequality.

1. For the interested reader, please consult for instance Roland (2000) or Berglöf and Roland (2007) for a more thorough overview.

2. The current situation of course partly depends on the severity of the initial chock, but more importantly on the ability to reform the economy and the political structure, structural factors such as natural resources and demographics, and the influence of outside actors.

3. Real GDP in 1999 was lower than that in 1989 in 23 of the 25 CEE and CIS countries (EBRD, 2000). The variation in the output fall and pace of recovery has led to a drastic divergence between the countries, though it should be emphasized that official figures may overestimate that difference because the informal sector has been growing in particular in the poorer countries. It should also be noted that China and Vietnam experienced no output drop when they started their reform programs, but this lies outside the scope of this paper.

The command economy emphasized industrial production, and favored large enterprises. The share of industry relative to services and agriculture was therefore at the outset much higher than in countries with comparable income levels, and so were the levels of investments in physical capital. During the early years, investments therefore fell substantially, the role of industry shrank, and labor reallocated, sometimes by choice, but often out of necessity. Unemployment shot up as a consequence, as did inequality and the size of the informal economy. On the other hand, the level of human capital was quite high for countries at this income level, as measured by life expectancy and school enrolment rates, but also in terms of industrial know-how and scientific knowledge due to the focus on industrial development (not the least the arms industry). The levels of inequality and poverty were also very low, though it can be discussed whether traditional measures of income inequality may be even more misleading as a representation of inequality of opportunities within the Soviet system.

So, what role did these initial conditions play for the following development of these economies? There are many different initial conditions that may matter, and many of them are highly correlated, so the common approach within the empirical literature has been to use factor analysis to identify a more narrow set of conditions that are particularly relevant. For instance, in De Melo et al. (2001), two dimensions are identified, one corresponding to the degree of macroeconomic distortions (such as repressed inflation and the black market premium) and lack of experience with a market economy and democratic institutions, while the other corresponds to the level of economic development, including over-industrialization, human capital and natural resources. Looking at average growth rates in the first five year period after reforms started, they find that the first factor has a direct negative effect on growth, whereas the effect of initial level of development is positive but mainly indirect, operating through the accumulated level of economic liberalization. This illustrates an important point, that the speed and mode of economic liberalization is endogenous and may in itself depend on initial conditions.

Geographic location is another important initial condition brought up in the literature. The direct or indirect role of geographic characteristics such as distance to major markets, access to the sea, agricultural productivity and incidence of tropical diseases is emphasized in the recent empirical growth literature (e.g., Gallup and Sachs, 1999; Rodrik et al., 2004). Factors such as these have no doubt played a role for some of the transition countries; think of the benefit of being close to the markets of Western Europe or being landlocked like the countries in Central Asia and the Caucasus. More importantly, however, has been the distinction between being a prospective future EU member, and being in the sphere of influence of Russia. The EU accession prospect created strong incentives to undertake economic and institutional reforms, and it created a unified national agenda and a sense of political direction and stability at a time of great economic and political uncertainty. This greatly reassured investors, both domestic and foreign, and kept a lid on the extent of corruption and state capture within the political system. Countries under the sphere of influence of Russia have at times benefitted from subsidized fuel imports and less of a disruption of the old trade-patterns, but they have also generally been plagued by more political instability and internal conflict over the future direction of their countries. They have also made very little progress with political checks and balances, feeding corruption, state capture and organized crime, and pushing much of the economic activity into the unofficial sector. Economic and political pressure from Russia has also prevented countries from creating stronger ties with the west, and regional co-operation, such as free trade agreements, are typically designed to benefit Russia itself foremost.

Political and Institutional Reforms

One of the main insights from the transition experience is that both the ability to implement economic reforms and investor response to economic reforms implemented depends crucially on the political and institutional context. It is therefore not very meaningful to talk about the relative merits of particular economic reforms in isolation. Instead, more useful insights can be gained by addressing the role of political and institutional reforms in creating an environment in which investors can trust protection of property rights and contract enforcement, where political accountability and transparency contains corruption, state capture and cronyism, and economic reforms are politically feasible. This is not to say that economic reforms necessary for internal and external balance, deregulation of markets and privatization are not important. The point is that the variation in the extent to which economic reforms have been undertaken (and how effectively they have been undertaken) to a very large extent depends on the underlying institutional and political framework.

Political reforms have been crucial to establish investor trust in protection of property rights and contract enforcement, contain corruption and cronyism, and impose accountability on political candidates and parties for their actions. The early literature on the relationship between regime type and reform progress, based primarily on the experience of Latin American countries in the 1970s and 80s and historical examples from Western Europe, emphasized the impediments to reform progress that comes from more checks and balances, political veto players and a generally more open and democratic system (e.g., Alesina and Drazen, 1991; Drazen, 2000). The experience of the transition countries, however, is quite the opposite; countries that early on reformed their political system, had more veto players and more constitutional checks and balances also made faster progress with economic reforms. This provided quite a puzzle at the time, since the major political challenge was expected from the general public during the "valley of transition", the early drop in economic output and productivity. The concern was that a more democratic system would fall prey to short-sightedness as well as populist pressure to stop the reform process. Politicians needed to be insulated from popular demands until enough benefits had been generated to make the reform agenda popular with the public.

An influential explanation for this puzzling result was given in Hellman (1998). He argued that partial reforms do not only produce losers within the general public but also winners within the politically connected elite. For instance, partial price liberalization, market prices on final goods together with price controls on inputs can create huge rents, in particular in non-competitive markets. Similarly, privatization of state-controlled monopolies without regulations to promote entry and competition in the market has led to massive wealth accumulation among a narrow group of oligarchs in many CIS countries. Yet, with a more open democratic system, and more checks and balances, the ability of the narrow elite to capture the state and halt the process at a partial reform stage is smaller. According to this argument, the main political challenge is to prevent winners, not losers, of partial reforms to capture the process, and such capture is easier in a less open, accountable and transparent political system. It has also been shown that popular support for economic reforms were greater in countries with more checks and balances on executive power, supporting the idea that the reform process is more likely to generate benefits to the general population when accompanied by genuine democratic reforms (Desai and Olofsgård, 2006).

It was not just elections that were missing in the early 1990s; the end of communism left the countries with a huge institutional vacuum. The economic transition required a legal system protecting private property rights, fostering competition, and supporting the evolution of financial markets. The political transition required constitutional reform, the emergence of viable and competing political parties, an independent judiciary, free press and media to contain corruption, and compliance from the security apparatus. None of this was pre-existing at the time, and the countries roughly evolved along two different tracks. In one track, corruption and state capture by economic elites was contained, partly thanks to a more open political system, but also because of a largely independent, honest and competent judicial system. This track represents the development of most countries in Central and Eastern Europe, and no doubt the prospect of potential future EU membership helped to motivate different actors to converge on it. Most of the countries in the former Soviet Union have followed a different track with state capture by small elites using the powers of political office mainly to protect their own economic interests.[4] This has been made possible largely by weak institutional development. The ability to hold politicians accountable has been limited by non-transparent policies, control of media, and harassment of political opponents and independent journalists. At the same time, a corrupt and politically dependent court system has made it possible for politically connected business interests to play by their own rules, causing uncertain property rights and unreliable contract enforcement for independent entrepreneurs and small and medium size enterprises. When happening under the disguise of democracy (or "managed democracy") this development has also led to a general distrust among the population of politicians and democratic institutions, further undermining the possibility of transition towards open and competitive societies.

The strong institutions have also been an important factor why in particular the Central European and Baltic countries have been so successful in attracting foreign direct investments (FDI).[5] Countries such as Slovakia, Hungary, Poland and the Czech Republic have benefitted greatly from an export-driven strategy, financed to a large extent by foreign investments. This is not only motivated by the institutional environment; early trade liberalization, devaluations and geographical proximity to major markets were also important to ensure competitiveness and the right environment for labor-intensive industrial production (that over time developed into more advanced consumer goods such as car assembly, and investment goods). However, given the shortage of domestic private capital, the countries (sometimes reluctantly) opened up for inflows of foreign capital, including in most countries the establishment of foreign banks and insurance companies. This has been crucial not only by bringing in the capital necessary to engage in strategic restructuring of the often obsolete production facilities, but also by providing know-how about successfully operating in a competitive market economy.[6]

The Politics of Economic Reforms

The relative role of reform progress for economic outcomes, and in particular speed of reforms and sequencing, is a more controversial topic. It is also methodologically challenging since the ability and motivation to undertake reforms partly depends on initial conditions, including political, financial and informational constraints. What is clear, though, is that the reform agenda has progressed very differently in different countries, and that it has rarely followed the typical textbook script of how to best proceed. Instead, the sequencing of reforms as well as their design has been largely driven by what has been politically feasible.[7] This led to a steady stream of compromise and accommodation. With the benefit of hindsight it is easy to point out mistakes and point out where compromise seemingly went too far. However, it should be emphasized that we do not know

4. Notable exceptions are the Baltic countries and more recently Georgia.

5. Natural resource rich CIS countries have also received substantial inflows of FDI, though less than the Baltic countries and Eastern Europe in absolute terms (but actually more as a percentage of GDP).

6. Numerous firm-level studies show the beneficial effect of foreign investments for total factor productivity (see the recent survey by Estrin et al., 2009).

7. It should be emphasized that the transition countries also faced other types of constraints that influenced the way reforms were conducted, such as lack of domestic private wealth, fiscal contraction, and shortage of managerial and regulatory skills needed in a market economy.

what would have happened in the absence of compromise, in other words, we do not know the counterfactual.[8]

One lesson from the transition experience is to make a clean cut with the past and take advantage of the immediate time period after such a dramatic event as the Arab Spring or the fall of communism. This is particularly important in the presence of political uncertainty, if there is a risk that the old guard may come back to power in the not too distant future. It is typically, both economically and politically, more costly to reverse reforms already in place than to stop a reform agenda not yet implemented. For instance, democratic reforms will be harder to reverse if free and independent media and opposition parties have already developed, and renationalization of privatized assets is far more complicated and politically sensitive than stopping a sale that has not yet been realized. The "trick" here is thus to create certain conditions that are costly to reverse, thereby making it more likely that even the old guard (or a revised version of it) prefers to continue the reform agenda if they get back into power.[9] In the Central and Eastern European countries all the politically right-wing or centrist governments that initially came to power (with one exception) lost power after one term to more left-wing parties or coalitions. However, the new governments facing the facts of what had already been achieved continued the reform process, sometimes even at a higher pace, despite typically running on a platform of reform critique (Fidrmuc, 2000).

Another reason to use the early window of opportunity to push forward with reforms is that the new government in power typically benefits from extraordinary political capital, at least for a while (sometimes referred to as a "honeymoon"). During this time period, the government may be able to politically get away with reforms that they would not be able to pursue in normal times. This is particularly true for reforms that may be necessary in the long run but carry short-term costs, such as price liberalization of subsidized goods, labor shedding as part of firm restructuring and privatization, and public sector reform.

Note that this does not mean that all reforms should be undertaken at once. The mode and sequencing of reforms should also be designed so that they increase the likelihood of continued reform progress. This means in particular two things. First of all, it may be wise to start out with reforms more likely to generate benefits in the short term to a wider share of the population in order to increase popular support for the reform agenda. This is particularly important if there is uncertainty about whether the reforms will really generate welfare benefits (aggregate uncertainty) and if early success sends a signal to the population that future reforms are more likely to generate benefits as well (Roland, 2000).[10]

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8. For instance, the designs of the main privatization programs in Russia caused asset stripping and lack of restructuring (the insider deals) and contributed to state capture, corruption and increased inequality (the loans-for share program) that still plague the country. However, the details of the insider package came about after two previous attempts had been blocked in the Duma, and the loans-for-share program was offered in the face of a fiscal and political crisis (the leader of the Communist Party, Gennady Zyuganov, was expected to win the upcoming presidential elections). It has therefore been argued that the most likely counterfactual in this case was no privatization and the return of the Communist Party to power, which makes it less obvious how to judge the actions undertaken (Shleifer and Treisman, 2000).

9. Formally, this is referred to as "state variable control" in the political economy literature, and the idea has been applied in many different settings (see for instance Persson and Svensson, 1989, or Cukierman et al., 1992, for pioneering applications).

10. Aggregate uncertainty with regards to typical Washington Consensus type of reforms is typically explained by context specific outcomes due to weak market-supporting institutions, or norms and expectations leading to unexpected individual responses to policy changes (contrary to the model world, where all such complications are ignored). Another explanation is uncertainty with regards to the ultimate intentions of the elite, when reforms can be designed either to benefit the majority or just a narrow elite (e.g., privatization and competition policy). In both cases, if early reforms are successful it sends a credible signal that further reforms are also more likely to be so, in the first case because the environment seems conducive to market reforms, and in the second case because the elite indeed seem to be of the types that are committed to follow a reform path that benefits the majority (Desai and Olofsgård, 2006).

Secondly, early reforms can also be designed to increase the number of stakeholders in support of continued reforms, or politically and economically empower existing supporters. For instance, the subsidized voucher privatization program to all citizens in the Czech Republic increased support among the electorate for a continued reform agenda, and is typically used to explain why Vaclav Klaus and his government was the only right-wing government in the region to be re-elected after a first stint in power (Earle and Gehlbach, 2003).[11] Reforms that encourage the emergence of a new entrepreneurial class are also often singled out as an effective way to boost future support for reforms. On the other hand, there are also examples of the opposite logic, when early reforms have emboldened groups that later have resisted continued reforms. The loans-for-shares privatization program in Russia was designed to help the relatively reform-oriented government of Yeltsin to remain in power when electorally threatened by the old communist party. The program, however, increased economic wealth and political clout of a small group of what was to be called oligarchs, who later emerged as an important impediment to the unsuccessful attempts to restructure the federal tax system (Shleifer and Treisman, 2000). Either way, the general lesson is that it is important to have a dynamic perspective and consider how the design and sequencing of reforms can help or hurt the political prospects for support of future reforms.

Natural Resources

Natural resources in the CEE and CIS countries have been a mixed blessing. On the one hand, they have been a source of economic growth and much needed external funds; on the other, they have caused large volatility in incomes, have arguably been a source of "easy money" for governments (thereby reducing the pressure to reform), as well as a source of corruption and rent seeking. These effects are by no means particular for this set of countries but fit the general picture of how natural resources affect economic development.

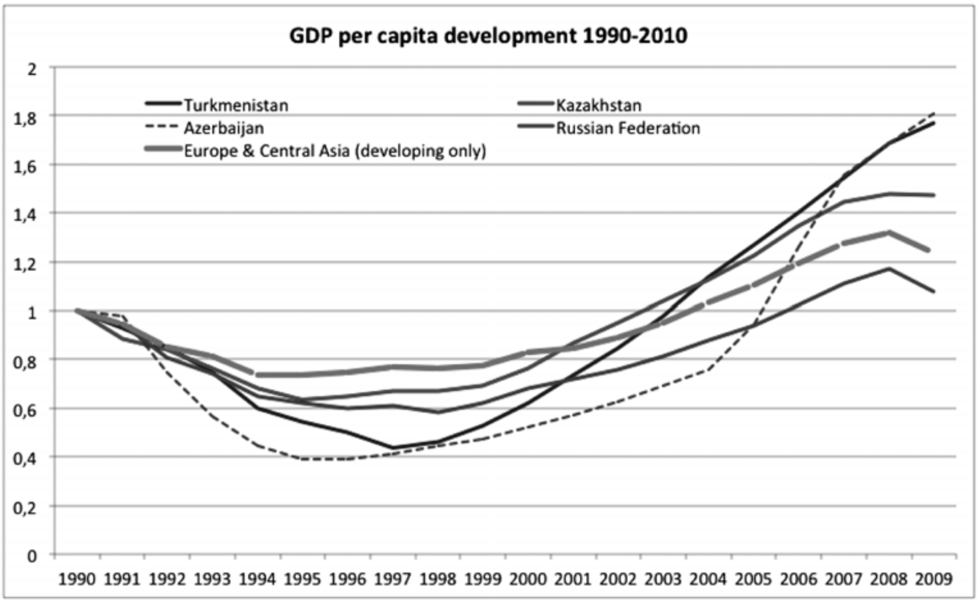
To recapitulate the main findings of the vast recent research literature on the topic, it is a well-known fact that resource dependence (typically measured as some kind of production or export of primary goods as a share of GDP) is negatively correlated with subsequent long-run economic growth. This relationship, first established in the seminal paper by Sachs and Warner (1995) is the basis for what is often referred to as the *resource curse;* that is, the idea that natural resources somehow undermine long-term economic performance.[12] However, given the fact that there are plenty of exceptions to this general rule, the relevant question is not really if resources are good or bad for development on average, but rather under what circumstances resources are good and when they are bad. The broad answer to this question is that the effect seems to depend on institutional quality. As shown by Mehlum et al. (2006) and Boschini et al. (2007), natural resources slow economic growth in countries with bad institutions, but contribute positively to growth if institutions are sufficiently good. Furthermore, Boschini et al. (2007) also show that this effect is stronger for more appropriable resources. Roughly speaking, countries rich in oil and minerals (as opposed to agricultural and food products) on the one hand experience more problems when institutions are bad but, on the other, benefit even more from their resources when institutions are sufficiently good.

The insight that the effect of resources depends on an institutional interaction effect is important in itself, but it also raises two additional issues. First, is it possible to be more precise with respect to what aspects of institutional quality matter and, second, what the (causal) relationship between

11. From a purely economic perspective, the program has been accused of creating weak and dispersed ownership which caused little restructuring and little replacement of weak managers, but it did serve a political purpose.
12. Its robustness has been confirmed in, for example, Gylfason et al. (1999), Leite and Weidmann (1999), Sachs and Warner (2001) and Sala i Martín and Subramanian (2003). Sala i Martín et al. (2004) find that the negative relation between the fraction of primary exports in total exports and growth is one of 11 variables which are robust when estimates are constructed as weighted averages of basically all possible combinations of included variables.

resources and institutions is. Here the overall finding with respect to the first point is that institutions regulating the relationship between government and citizens are the key (as opposed to institutions which enable private contracting between citizens).[13] With respect to the second point, the general finding seems to be that resources do indeed slow both economic and political reform processes.[14]

Overall, the experience of the most resource intensive transition countries can serve as a good illustration of these effects. Focusing on the most fuel and mineral intensive countries in the region, Azerbaijan, Kazakhstan, Russia, and Turkmenistan, they illustrate some of these general results. In terms of economic growth, it does not seem as if these countries have suffered from having natural resources. In recent years especially, economic growth has been spectacular in Azerbaijan and Turkmenistan in particular, but also Russia and Kazakhstan have done well, highly due to resource incomes. Compared to the average growth over the period in developing Europe and Central Asia, the resource intensive countries have grown faster.[15]



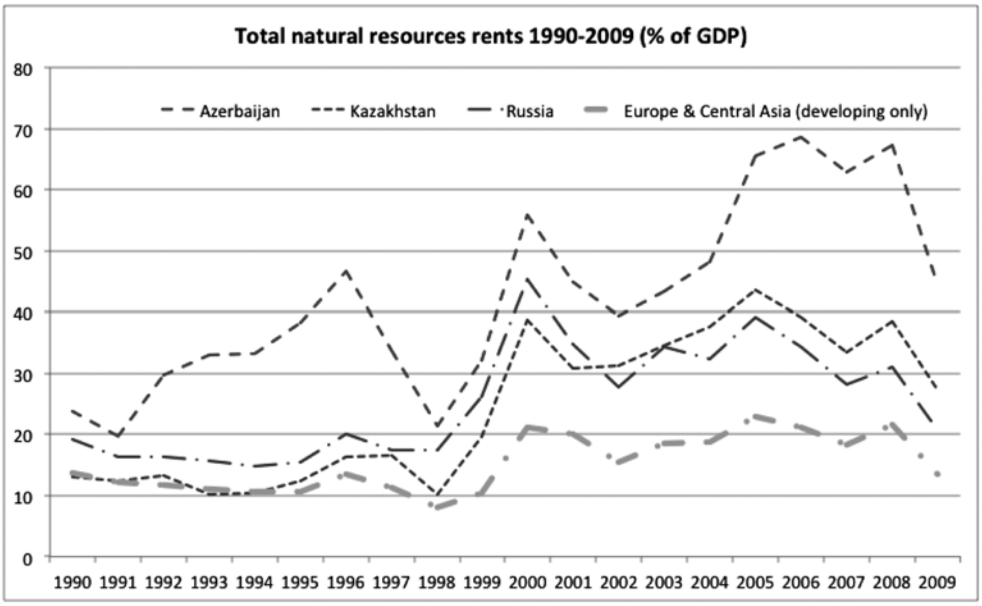
But even if economic growth looks strong there can still be economic problems related to resource dependence. The main economic problems involve difficulties of diversifying away from the resource intensive sectors, macro volatility and also decreased incentives to invest in human capital. When it comes to dealing with these issues the transition experience is again mixed. Diversification away from natural resources has proven difficult. In Azerbaijan and Kazakhstan the share of mining and fuels has clearly increased as a share of total exports. Even if the trend is not as clear in the case of Russia, resource-based exports have grown here too (see Guriev, Plekhanov and Sonin, 2009, for more details). Total natural resource rents as a share of GDP have also increased over

13. In the language of North (1981), it is useful to distinguish between “property-rights institutions”, which protect citizens (and firms) against expropriation by the government, and ”contracting institutions”, which enable private contracts between citizens (Acemoglu and Johnson, 2005). Boschini et al. (2011) find that only property-rights institutions seem to matter for reversing the resource curse. This of course is not to say that contracting institutions are not important, but only that they do not seem to have a reversing effect on this particular problem.

14. This is by no means a settled question though. Some, such as Haber and Menaldo (2011) and Treisman (2010) argue that resources do not hinder democratization and reform; others, such as Aslaksen (2010) and Andersen and Ross (2011), find support for a political resource curse. The main problem lies in finding situations where resources can credibly be thought of as exogenously given. Tsui (2011) uses the exogenous variation in oil endowments (an estimate of the total amount of oil initially in place) to instrument for the amount of total discovered oil to date, and finds that oil does hinder democracy.

15. Russia is still below the level of developing ECA over the period 1990-2010 but has grown faster since 1999.

the period (though perhaps trending down slightly since 2000 for Russia).[16] There is also some evidence of resources crowding out educational investments (Suslova and Volchkova, 2007).



Financial sector development has been stronger in Russia, at par with other transition countries in Kazakhstan, but somewhat weaker in Azerbaijan and Turkmenistan. All countries have established sovereign wealth funds (though Turkmenistan very recently) to deal with "excess" government revenues from oil and gas during years of high prices. By and large, these have served their purpose and have made it possible to pursue countercyclical policy. In particular, the countries were able to dampen the effects of the recent financial crises thanks to their substantial reserves of foreign currency.

When it comes to effects on institutional development the picture is bleaker. Beck and Laeven (2006) show that transition countries that are more reliant on natural resources are more likely to see former communists remain in power and to start the transition process with less open political systems, with negative repercussions for the development of market-compatible institutions.[17] Guriev, Kolotilin and Sonin (2009) show that a number of institutional indicators in resource rich transition countries have lagged behind the average development and, in particular, that higher oil prices correlate with worse developments (see the appendix for two figures illustrating the development of commonly used indicators of democracy and checks and balances on the executive). Others have found negative effects on corporate governance (Blanchard et al., 1994; Durnev and Guriev, 2007), media freedom (Egorov et al., 2009), and reforms that improve the operating environment for medium-sized businesses in non-resource sectors (Amin and Djankov, 2009). In unstable societies resource revenues may substantially undermine social cohesion, increasing the likelihood of civil unrest and armed conflict (Ross, 2006).

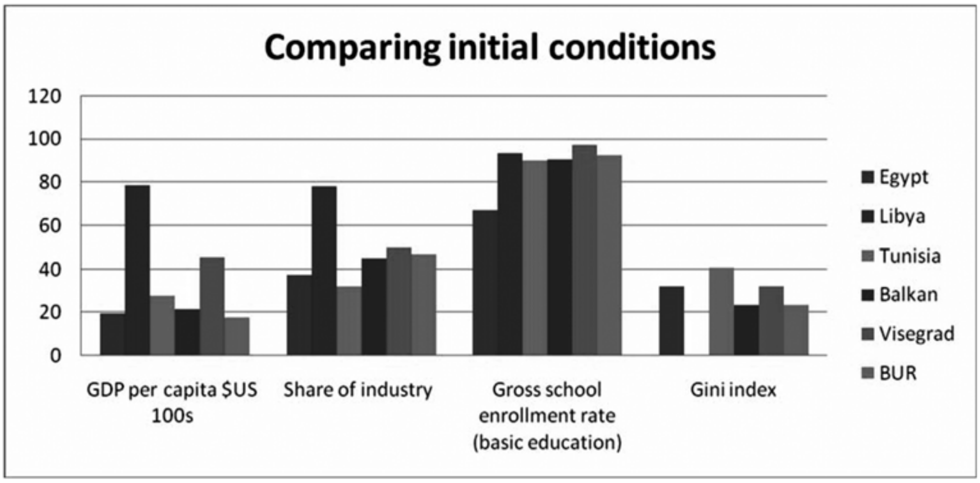
16. Total resource rent per unit of resource is defined as: market price less production cost. The total rent is the sum (over all commodities) of the number of units times the rent per unit.

17. Esanov et al. (2001) also found early evidence of the adverse impact of oil revenues on reform progress in Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan.

Lessons for the Mediterranean Arab Countries

Before getting into what the experience of the transition countries can tell us about the Mediterranean Arab countries, it is important to clarify some key differences between the two groups of countries. First of all, the Mediterranean Arab countries are relatively integrated into the world economy, and even though they typically have more public involvement in economic activities than most developed market economies, they are certainly no command economies. In that sense the extent of economic and market-supporting institutional reforms necessary are less far reaching, and of a somewhat different character. The challenge is not the creation from scratch of a market system as in the transition countries, but the challenge of deepening market reforms to make them better functioning and more independent from government control, and in particular a widening of access to the opportunities of the market economy to a broader segment of the population. This entails some privatization, some financial market liberalization, and some trade deregulation, but in particular it requires regulatory reforms that encourage new investors (both domestic and foreign), a sound competition policy, and a competent and independent judiciary, while discouraging corruption, cronyism, and excessive government involvement. Many of the economic policy challenges are thus of a more conventional type for developing countries, and may more resemble the current obstacles in the less developed CIS countries than the situation in the early 1990s in the transition region as a whole.

Secondly, with the exception of Lebanon and the special case of oil rich Libya, the countries are poorer than most of the CEE countries and Russia were in 1990, and the level of industrialization and the human capital and know-how that comes with that (with the exception of natural resource rich Libya and Algeria) is also lower. Furthermore, levels of poverty and inequality are much higher in most of the Arab countries, and social indicators such as school enrolment and gender equality also fall behind with a few exceptions. Some of these differences are illustrated in the figure below, and with more detail in Tables 2 and 3 in the appendix.[18] Similarly, when it comes to political structure and experience with more democratic institutions, the Arab countries are generally much closer to the less developed CIS countries in Central Asia and the Caucasus than the CEE countries. With the exception of Lebanon, the countries have basically no experience of democratic rule, and the political structure is typically referred to as a client-based (or neopatrimonial) network of hierarchies built around kin-based loyalty and the allocation of private benefits.[19]



18. The country groups are taken from Campos and Coricelli (2002), and are defined as follows: Balkan (Albania, Bulgaria, Moldova, Romania, Croatia, Macedonia), Visegrad (Czech Republic, Slovak Republic, Poland, Hungary, Slovenia), BUR (Russia, Belorussia, Ukraine). Data for the transition economies are from 1990 or the closest year after that for which data is available. The data for Egypt, Tunisia and Libya are taken from 2009 or the most recent available.

19. There is of course a lot of variation in the details of the political structure; some of the countries are monarchies, others military or one-party dictatorships, some countries are quite homogenous, others are more divided along ethnic, tribal or religious lines. The main thing they have in common, though, is the lack of experience with democratic institutions and the centralization of power within a narrow group of elite actors with little accountability to a majority of the population.

Building Genuine Democracy

In order to establish a lasting foundation for a deeper democratic development, the new social contract should be based on a precept of ensuring full and secure participation of the region's social constituencies, be it women, Islamists, as well as religious or ethnic minorities. Behind this lies a conviction that the further development of the Arab world lies not in new promises of a gilded future in exchange for democratic freedoms, but a broader empowerment for the population to decide the future for themselves. Instrumental for this is the setting up of institutional guarantees for human rights as well as ensuring the independence of media and civic organizations. The outcome of the current process to rewrite constitutions will therefore be an important indication of the future direction of the region.

In the discussion on deeper democratization there are many issues to tackle, but two issues stand out as particular, both in importance as well as applicability to the region. The first is the need for a deeper empowerment of women in order to tap into a vast, often unappreciated and undervalued social "reserve". The second is a commitment to full and secure democratic participation for all of society's political and social actors. This will include removing barriers to entry in politics and economics in general, not only for women and religious or ethnic minorities, but also for groups with a record of more or less anti-democratic views, such as Islamists.

Gender equality in the region remains one of the greatest economic and political concerns to date. The *Arab Human Development Report 2005* was particularly scathing in its review of how countries have failed to promote women stating that "Arab society does not acknowledge the true extent of women's participation in social and economic activities and in the production of the components of human well being, and it does not reward them adequately for such participation." This problem stretches through all elements of society from the poor rural classes where female circumcision is still common to the upper halls of parliament where women stand out in their absence.[20] This comes despite recent gains in increasing women's education (UNDP, 2005). Yet the most striking field in which gender inequality manifests itself remains labor. As shown in Table 4 in the appendix, average female labor force participation is around 26 percent in the region, half that of the world average. Only an equally poor record of participation in politics matches this abysmal rate: less than ten percent of the region's members of parliament are women. Part of the reason may lie in deeper cultural barriers to entry for women, yet direct policy outcomes also correlate well with the large amount of women who remain at home; on average Arab countries spend roughly half as much of GDP on health and childcare as the world average, leaving few options for women with children.

An established stylized fact is that poverty breeds gender inequality (Duflo, 2005), and in this spirit policymakers have come under the assumption that gender-neutral growth-enhancing policies will in time also achieve improved standing for women. Yet to attribute the Arab world's low female participation to poverty would be to overlook the fact that poorer regions also have higher rates of female participation (such as Sub-Saharan Africa – see Table 4). While the achievement of equity can be seen as valuable in itself, there is also research suggesting a causal link between empowerment and development outcomes. For example, women as policymakers have been documented as investing more in basic infrastructure at the local level (Chattopadhyay and Duflo, 2004).

20. For example, in Egypt female gender mutilation and circumcision is considered "almost universal among women of reproductive age" (UNICEF, 2005).

While welfare-enhancing effects of gender-equalizing policies to date remain ambiguous, most would agree that a larger pool of educated citizens, skilled workers and politicians with varying perspectives are positives. In fact, most of the more interesting questions, such as whether women's inclusion in the labor force affects economic performance remain uninvestigated. Until then equality remains the strongest motivation for female empowerment and perhaps the best measure of the arrival of equality is when women elected into office are just as competent (or incompetent) as the men already there. In short, the prospects for serious political development will always be in doubt as long as half of the population is systematically absent from public participation. The long-delayed empowerment of women in the region should therefore be a first priority.

The second main issue with regards to deeper democratization is to what extent Islamism and democracy are compatible, a concern frequently brought up in the region. Islamism previously served as the opposition preferred by dictators. A common story spanning from Egypt to Tunisia has been that strong rulers and security apparatuses were the only thing that stood between Islamists and a regional cataclysm (The Economist, 2011). A distorted outcome ensued whereby the only (barely) tolerated opposition was the one held up as a reason to preserve the authoritarian regime. This not only undermined the formation of alternative political movements, but also provided a singular view of Islamic movements. As Arab countries move towards more open electoral systems of government, skeptics claim that the genie is out of the bottle once Islamists start winning elections, claiming as evidence previous experiences in Algeria, the West Bank and Gaza, and the recent intention of the terrorist-labeled Egyptian Islamic Group (Al-Gamaa Al-Islamiya) to start a political party.

Despite concerns over radical and sometimes violent followers of Islam, these remain a minority compared to the more mainstream and moderate Islamic movements in the region. This includes not just the Muslim Brotherhood, but also Ennahda in Tunisia. These organizations are as much social as they are political and have provided one of the few building blocks of civic society in countries where regimes have otherwise worked hard to purge such organizations. Islamic organizations in the region are indeed more than parties; they are providing many of the services the state should be providing. Health clinics, educational facilities, and poverty alleviation are integral components of these movements' activities (Blaydes, 2010). Excluding political Islamic organizations would thus exclude a large segment of civil society, and in particular there is a risk that it could turn them more radical (Pokladnikova and Yildiz, 2009). Instead, a more transparent and open political system typically moderates Islamist movements and curtails extremist groups. Cross-country comparisons of countries with experience of Islam and democracy document that "the fairer the elections are, the worse Islamic parties fare" (Kurzman and Naqvi, 2009).

One of the few instances where Islamic parties have been able to participate in elections is Turkey. In the mid-1990s a relatively radical Islamic party, Refah, became the senior coalition government after winning the most votes. Refah's strong Islamic ideology alienated many including the secular establishment, yet, perhaps surprisingly, a significant portion of its support came from women (Arat, 2005). Again, the strong support for an Islamic party by women may have come from its policy focus on areas considered important for this group, such as health, education, and poverty (Meyersson, 2011; White, 2002). This phenomenon can also be found in Egypt where women's support for more or less strict Islamic movements stems from economic considerations more than anything else (Blaydes, 2008). The relationship between Islamic parties and the life of women is thus more complex than the common media picture, and female supporters may moderate the stance on gender roles in Islamic movements over time.

The most important aspect of the experience of Islam and democracy in Turkey is probably the subsequent moderation of the party's Islamic ideology over time. This moderation was in part due to judicial interference in the political process, banning both Refah and a follow-up party, but also the conventional political logic of gravitating towards the ideological middle ground in order to increase electoral support. The best weapon against radical Islam in Turkey may not have been a hostile security establishment, but the characteristics of the median voter, most likely a woman. The electoral success of the Islamic party Ennahda in Tunisia has given rise to a fervent debate about the future development of the country. Tunisia has been relatively progressive when it comes to women's rights, and leading party representatives have said that none of that will change. But there has also been a reported increase in attacks on female teachers, and television channels sending movies directed by female directors. The big question now is whether the party's sudden rise to power will embolden more radical elements or, as in the case of Turkey, lead to moderation as the party feels the need to encapsulate the preferences of broader segments of the society.

Earning Credibility through Institutional Reform

Protesters have demanded not only elections, but change in a system they perceive being stacked in favor of the existing elite. Protests were fueled by perceptions of rising inequality, corruption and repression together with increasing unemployment. Political legitimacy in these autocratic states have for long relied on what has been referred to as an "authoritarian bargain" by which citizens tacitly comply with lack of voice in exchange for a certain level of political stability and economic security (Desai et al., 2009).[21] This economic security has largely been provided through the state, which at least for the upper and middle classes has provided a certain minimum level of public services, and perhaps more importantly, employment opportunities in the public sector. With stagnant economic growth and the demographic bulge significantly increasing labor supply, it has become harder and harder for the regimes to fulfill their part of the bargain. In particular the young generation feel left out, while insiders have defended the privileges they have befitted from. This has created what has been referred to as "a generation in waiting", a generation that cannot find stable jobs in the official sector, which has stopped them from getting access to finance to buy a home, which in turn has forced them to wait for marriage and children (Dhillon and Yousef, 2009).

What is demanded for social peace is a new social contract with democratic institutions and where economic opportunities are more equally allocated. The key though is that this will be a long-term process so to achieve political stability the process must be credible. Lack of credibility often comes from a history of selective implementation of laws and regulations, benefitting existing economic elites at the cost of new entrepreneurs (World Bank, 2008). To guarantee the ability to allocate scarce resources for the purpose of political survival, regimes are reluctant to cede real authority to agencies responsible for policy implementation, to allow decision-making to be truly rules-based or expose the regime to outside accountability (Bates, 1981; Acemoglu et al., 2003). One major uncertainty in countries like Egypt and Tunisia in this regard is to what extent the old economic and political elite will be able to maintain their privileges. Obviously, the ruling families are gone, but within important institutions of power such as the military, the judiciary and the bu-

21. The authoritarian bargain has been used to understand the longevity of authoritarian rule in the Middle East and North Africa, but also to explain the sudden demise of powerful regimes in countries during the Arab Spring. In times of political pressure or financial stress, the bargain may break and the ruling regime may crumble, even in cases where it has resorted to the use of repression and force to maintain power. To sustain the bargain, the ruling elite must be able to provide the economic benefits citizens have come to expect. Whether this has been sufficient to buy acquiescence has depended both on the strength of discontent and how generous these benefits have been. In oil-rich countries with plentiful financial resources (e.g., Saudi Arabia), generous economic benefits seem to have been enough, but in countries without such financial resources, partial political liberalization has also been undertaken to stave off discontent, for instance in Morocco and Jordan.

reaucracy, the old guard is still present.[22] The cronyistic relationship to a narrow set of economically powerful families also largely prevails, though some tycoons have been indicted for embezzlement and squandering public funds (Saif, 2011). A key challenge for the future is thus to find ways to build trust and credibility into a political culture plagued by mismanagement, nepotism and distrust.

As pointed out in World Bank (2008), lack of credibility and weak enforcement is behind much of the economic problems motivating the protests. The lack of private sector growth and job creation within the region depend less on lack of de juro reforms, and more on lack of implementation and enforcement. As the experience of the transition countries suggest, it is crucial to cut with the past and send a credible signal that change is coming. The institutions in charge of implementing and enforcing policies of new and democratically elected governments must also be reformed so that the incentives are right, and the competence is there.

Lack of credibility is particularly acute in non-democratic and recently democratized countries in which competitive elections do not serve as a constraint on public expropriation of private investments. An alternative source of credibility in this context is institutionalization of the leading organizations in charge of deciding on, and implementing, policy, such as the ruling party, the bureaucracy or the military. Institutionalization here includes a transparent and meritocratic system of compensation and promotion, delegation of real authority within the organization, and rules-based procedures for dealing with internal conflicts. Together with a unified and transparent objective of the ruling organizations, and incentive schemes within the organizations consistent with those objectives, private agents can better trust that announced policies will be implemented consistently and according to rules, rather than based on personal interests within the elite. Institutionalization thus de-personalizes the organizations in charge, promoting a long-term perspective for the organization's political survival rather than the elite's typically short-term political survival. Examples of institutionalized organizations cited in the literature are the Chinese Communist Party, the civil service in Singapore and the military in Chile during Pinochet.

The importance of the prospect of joining the EU for CEE countries cannot be overestimated. An outside anchor gives direction to the reform process (in the EU case with clearly defined convergence criteria), credibility to the stated policy objectives (a reform agenda captured by a narrow elite and marred by corruption, nepotism and cronyism would not pave the way for EU membership) and a clear final goal that most segments of society agree upon, thereby reducing political instability and social tensions. An outside anchor can also offer a direct reward in exchange for reforms, as in the case of aid conditionality from international financial institutions or bilateral donors. This can help overcome political resistance by providing resources to compensate losers, and increase commitment by providing a scapegoat to blame for unpopular reform programs.[23]

For the Mediterranean Arab countries, joining the EU is of course not a viable option in the foreseeable future, but alternative institutional set-ups may help build political stability and credibility. A partnership program with the EU countries can help, but the experience of the CIS countries is not entirely encouraging. The European Neighbourhood Policy (ENP) towards the East has generated very little political and institutional transformation (with the possible exception of Georgia, but the role of the ENP is unclear). The EU is supposed to be a normative and regulatory anchor, but there is basically no convergence towards European institutions, and most of the countries re-

22. The military was initially one of the few trusted institutions in Egypt, and during the uprisings they were applauded for their restraint. A lot of that trust has evaporated in the aftermath, though, as the military has been blamed for violence, indifference when Christians have been attacked by Muslims, protection of their own privileged status, and for dragging their feet with regards to preparing the country for democratic elections and a new constitution.

23. In particular, the IMF has historically taken on the role of the scapegoat to provide some political backing to governments implementing controversial reforms. Lately, the IMF has become less willing to take on that role, though, and together with the aid community more generally emphasized the importance of partner country ownership of its reform agenda.

main semi-autocratic and struggling with corruption, cronyism and inefficient and unequal economies. It seems like the ENP is not offering strong enough incentives to motivate elites in these countries to give up some of their political power and monopoly over rents (CEPS, 2011). In response to that the EU Commission and High Representative have suggested in a review of the NEP that the southern neighbors need "more for more"; that is, more aid with more conditionality. More resources for investments have been pledged and greater market access for export goods, but this is made conditional on the building of "deep democracy". Whether this will be enough to make a difference is impossible to say at this point, but it requires the conditionality to be credible, something that is often a challenge in the face of either commercial opportunities or humanitarian crises.

Overcoming Political Resistance

There is a tremendous amount of uncertainty with regards to the political future of Egypt, Tunisia, Libya and Syria, but the other countries in the region are of course also affected. It is therefore premature to try to identify country specific "champions of reform" and from where the major resistance will come. Offering targeted advice on political tactics for making reforms implementable is therefore not possible. However, there are some more general lessons to be learned from past experience.

The first such lesson is the importance of putting the initial "honeymoon" to good use. Early reforms that make reversal into authoritarianism, cronyism and unsustainable public sector-led development less likely are crucial, in particular with all the current political uncertainty. This, of course, requires that the new government coming into power is considered legitimate (otherwise there will be no honeymoon), which depends on the process leading up to elections. It is therefore alarming to see the current situation in the run-up to the parliamentary elections in Egypt, as well as the loss of trust from segments of the population with the interim military council. With political legitimacy comes patience, also from groups that may see their earlier privileges curtailed. To reduce tensions between generations, classes, religions and urban dwellers and rural inhabitants, the process must be transparent and deemed fair.

A second lesson is to think wisely when accommodating policies to make them politically possible. If the alternative is no reforms, then adjustments may seem unavoidable, but it is important to take a dynamic perspective and consider how the adjustment affects the chances of gaining support for future reforms; that is, to think about the reforms as a process. Accommodation towards groups that question democratization or open and competitive markets can make them politically more powerful, either because they gain financial strength or because they earn some political legitimacy.[24] Instead, try to build coalitions that strengthen groups with a stake in future reforms, such as entrepreneurs and groups currently largely side stepped, such as the young, women and ethnic or religious minorities. At heart, the needed reforms concern a transition from privilege for the few to open competition for all, both in the political and economic sphere. Such a process is most likely to get support from groups currently outside the elite.

Empowering groups in favor of market reforms can also be achieved by increased public-private dialogue and partnerships. In particular, business associations representing small and medium size enterprises (enterprises not currently benefitting from political connections) and young entrepre-

24. Sometimes an alternative to accommodation is for the government to use its agenda setting power to bundle more popular reforms with equally important reforms that may face resistance from groups within the parliament. For instance, all groups may agree on the necessity of macroeconomic stabilization in the presence of unsustainable budget deficits and/or hyper inflation but may disagree on the need for privatization. By offering the parliament a take-it-or-leave-it offer on the package rather than two separate reforms, privatization may become politically feasible.

neurs can often be important stakeholders in support of reform. This is particularly important in a region in which there is a great deal of mutual distrust between the public and the private sector. As highlighted in World Bank (2008), not only private entrepreneurs distrust the competence and honesty of public institutions and officials. Almost two thirds of public officials interviewed across the Middle East and North Africa region thought of the private sector as rent seeking and corrupt. This lack of trust is often used as a motivation for excessive government involvement in the economy, but excessive regulation and control in itself feeds red tape and corruption. Dialogue and partnerships can help build trust over the longer run, thereby creating a first step towards a more open, rules-based and less corrupt relationship between the public and private sectors.[25]

Finally, as emphasized above, reforms will only lead to the anticipated response among private actors if they are deemed as credible; that is, if they are interpreted as signals of real change. This credibility can be earned through institutional reforms as suggested above. A slightly different credibility problem arises in a situation in which reforms may affect both economic efficiency (the size of the pie) and the relative returns to different factors of production (the shares of the pie going to different groups). If citizens are uncertain about to what extent the reforms really increase efficiency, then a party representing groups that gain in relative terms will have a harder time earning support from other groups for the reform. The reason is that this party would have incentives to push the reforms even if it did not produce efficiency gains, since it benefits its constituency. A party representing a group that loses in relative terms, on the other hand, is much more likely to get support if it pushes the reform, since citizens understand that this party would not promote these reforms if it did not know (or strongly believe) that the size of the pie would increase.[26] In the context of the Arab Mediterranean countries, what this means is that a reform-oriented government can increase the credibility of reform if it also includes groups concerned of being negatively affected (e.g., parties representing workers in import competing industries or public employees, or maybe Islamist parties emphasizing a bigger role for the public sector). Building coalitions with parties not typically associated with market reforms may thus be a way to bolster the credibility of the reforms, and thereby their public support.

Natural Resources: Challenge or Blessing?

As was pointed out above, resource wealth seems to be a mixed blessing. Resource incomes can help finance capital accumulation and public goods. Sovereign wealth funds (based on resource incomes) can act as a buffer to reduce the impacts of macroeconomic shocks and allow countercyclical policy. On the other hand, diversification away from natural resources has proven to be difficult. This seems to be especially true for oil and gas production, sectors with fewer connections to other exports in terms of required production capabilities.[27] And most importantly resources seem to have reduced incentives to reform the economy and develop strong institutions. Resource wealth may also create incentives to engage in corruption and rent seeking and in the worst cases

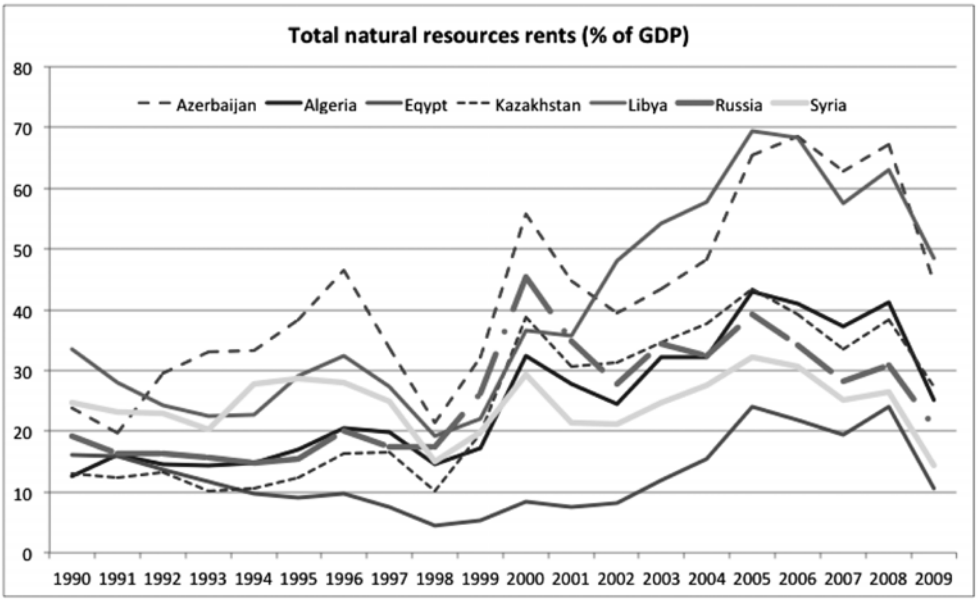
25. Partnerships can also help solve hold-up problems when incentives for private investments depend on public investments, and the other way around. For instance, to start prospecting investments in hotels and restaurants in a potential tourist spot, private actors need some reassurance that roads will be built, a sewer system will be in place, maybe that there is an airport nearby, and so on. These are typically public investments, but even a benevolent government will only have incentives to pursue these investments if it is assured that private actors will respond with investments in hotels, etc. This can create a hold-up problem and the greater the distrust between the public and private sector, the more likely it is that it will arise. Public-private dialogue can be an instrument to reduce the problem.

26. This logic is formalized in Cukierman and Tommasi (1998) in a paper cleverly called "Why Does It Take a Nixon to Go to China?".

27. Chapter 4 of the EBRD *Transition Report 2008* discusses connections between sectors. The report argues that the oil sector, relative to higher-value-added manufacturing (for instance, in the automotive or electronics sectors), is poorly "connected" to other export sectors in terms of the ease by which capital and labor can move between sectors, and in the potential for positive spillovers. This implies that natural resource dependent economies may have a harder time diversifying into production and exports of new goods and services, requiring more substantial investments in new capacity building and technological transfers.

even armed conflict to gain control over resource incomes. Generally, these problems tend to be worse for countries with less developed institutions and especially so if countries are rich in fuels or minerals.

Comparing the most resource intensive Mediterranean Arab countries with their CIS counterparts in terms of resource dependence there are several similarities. The figure below illustrates a comparison in terms of the share of natural resource rents in GDP in 1990-2010.

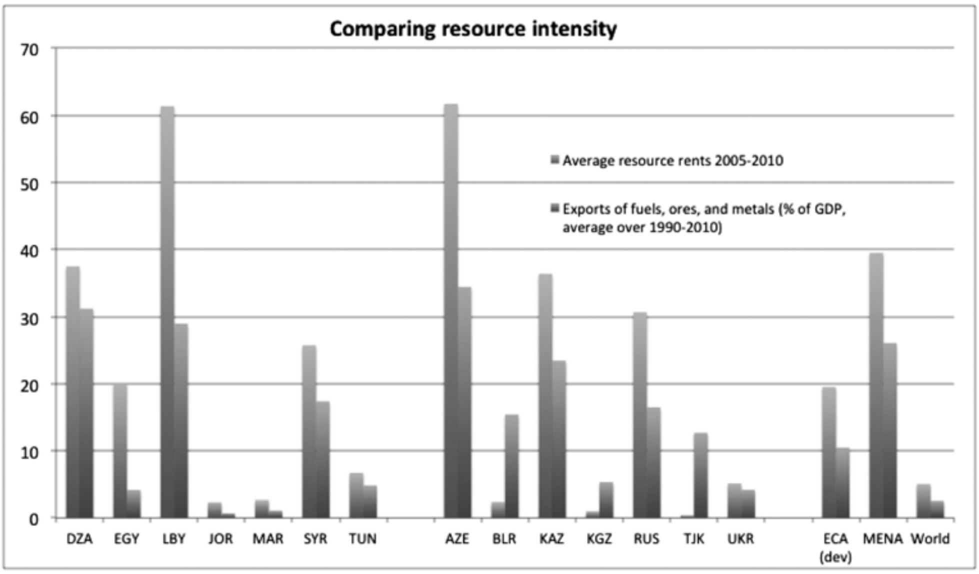


As can be seen, resource rents are at similar levels and have also followed a similar pattern over time. They are also comparable in that oil and natural gas constitute the most important resource in these countries. In absolute terms, Russia is clearly the largest producer of both oil and gas, but Algeria, Egypt and Libya are in the same range as Azerbaijan, Kazakhstan and Uzbekistan.[28] An alternative measure of resource intensity is the value of resource exports in GDP. The chart below shows exports of fuels, ores and metals as a share of GDP (the average value over the period 1990-2010) compared to the total resource rents in 2005-2010. Compared with the world average, it is clear that both the MENA region and developing Europe and Central Asia are very resource rich and again that there are several countries with similar levels of resource dependence. Though not fully comparable, the comparison also illustrates that fuels, ores and metals are dominant resources, and that most of the resources are exported.

As discussed above, a key finding in cross-country studies of the impact of resource wealth is that it is highly dependent on institutional quality. Given the turmoil and rapid political change in the region, it is of course unusually difficult to establish the state of institutional quality. However, if one looks at past measures it is fair to say that the range of assessments of political accountability, quality of government, levels of corruption, media freedom, and so on, range from relatively poor to intermediate. In short, the region does not stand out as one where the institutional quality would

28. In 2010 Russia produced some 10 million barrels of oil per day and about 610 billion cubic meters of gas. The corresponding figures for Algeria were 2 and 85, for Libya 1.8 and 15, for Kazakhstan 1.6 and 35, for Azerbaijan 1 and 16, Egypt 0.6 and 62. Uzbekistan produced only some 60,000 barrels of oil per day but 61 billion cubic meters of gas.

insure that the problems of resource wealth observed elsewhere would not be prevalent. Perhaps more importantly, the evidence that in institutionally fragile environments resources tend to slow down institutional development and reform (if not reverse it) should send the message that resource rents need to be tracked carefully and that transparency in the government budget process is of necessity. At the very least, it would be a mistake to think that vast resource incomes somehow automatically transform into positive economic and political developments.



Conclusions and Recommendations

In this paper we have argued that the Arab Mediterranean countries can benefit from looking at some of the experiences of the CEE and CIS countries. Initial conditions are different and the magnitude and type of challenges ahead are not identical, but there are enough similarities to make a meaningful comparison. Moreover, the international community can learn something about how to best support the countries of the Arab Spring based on their experiences with the CEE and CIS countries, as well as other countries in similar circumstances.

- *Conditionality must be credible.* Aid conditionality has a long history of failure. Fully state contingent contracts cannot be written and incentives to renegotiate the terms arise for reasons of time inconsistent preferences when looking at concessional lending (the soft budget problem illustrated for instance in Kornai et al. 2003) or the Samaritans dilemma when discussing grants (e.g., Gibson et al., 2005). The idea that "more for more" is going to make a difference for the southern neighborhood countries is thus far from obvious. In particular, it is not primarily about requiring more, it is about making conditions based on respect for human rights, democratic principles and rule of law credible. And this is not fixed simply by promising more help if the requirements are fulfilled; the lack of credibility comes primarily from the donors' lack of incentives to follow through on the conditions. More attention should instead be paid to how to organize aid in a way to minimize the credibility problem, something that will require co-ordination between donors, alignment around objectives and expectations, and a clear rules-based exit strategy when requirements are not honored. As the lesson from Russia suggests, this will be even more challenging towards countries rich in much needed natural resources, such as oil rich Libya.

- *Respect ownership.* In some ways ownership may seem incompatible with conditionality, but it can also be regarded as a distinction between means and objectives. Credible conditionality around a set of basic principles does not preclude the recipient government from formulating its own development objectives (as long as the basic principles are not violated), priorities and means to reach the objectives. The experience of the transition countries suggest that reform progress requires flexibility and local knowledge about political constraints and how they can be overcome. It also requires a great deal of local credibility in order to get public support and stoke social unrest. A process perceived to be enforced from abroad may lead citizens to question whether reforms really are undertaken in their interests, and may thereby undermine trust in the local government. The EU convergence process, for instance, stipulated a set of objectives but it was up to the candidate countries to design and domestically legitimize a set of policies to get there. In the case of the Arab countries, distrust of western powers and western culture and values run deep among large segments of the population. If western powers are seen as meddling, these groups are likely to turn their back on the process and may become radicalized, threatening social peace and de-legitimizing the transition process. This is particularly true when it comes to the attitude towards Islamic parties. Western powers are often found torn between preaching for democracy and human rights while concerned with political instability, trade flows and strategic co-operation. To maintain credibility when promoting democracy, support cannot be selective; also, Islamic parties should be judged by their deeds once in power.

- *Don't overspend.* Everybody wants to be seen as supportive of the Arab Spring and there is political goodwill to be earned from being generous and engaged (as well as potential commercial benefits). It is important, however, not to forget about common prudence in investments and aid management. Excessive inflows often feed corruption and rent seeking, complicate macroeconomic management, reduce the incentives to undertake reforms, and, if flowing through the state, reinforce the role of a state already over-involved in the economy. Even concessional lending can also cause future fiscal problems, if investments yield a low social rate of return. As is evident from the example of the CEE countries, foreign direct investments and aid can help the development of the economy and the progress of the reform process. It needs to be at a manageable level, although the experience from other countries recently flooded by foreign capital (e.g., Afghanistan and Iraq) shows that more is not always better. It is particularly important that the European governments do not get involved in a race to get strategic, political and commercial benefits by overbidding each other in generosity. This is likely to be counterproductive to the important internal process these countries face. Instead, European governments need to get involved for the long run and co-ordinate their actions to do the least harm.

- *Help make natural resources a blessing, not a curse.* Natural resources have generated economic growth and large incomes to the governments of resource-rich CIS countries, and it has enabled them to accumulate funds to engage in countercyclical policy and spend on public investments. On the other hand, these countries have not been able to diversify their economies, and, most importantly, resources seem to have slowed economic reform, democratization and institutional development. The role of the international community in this process is important. Unfortunately, there is a history of western governments focusing on political stability and commercial interests rather than democracy and human rights when dealing with resource-rich autocracies. This has of course reduced the urgency of ruling elites to reform, and eroded the credibility of any political conditionality on aid transfers. It is therefore important that the international community helps countries like Libya to establish institutions that reduce conflict and rent seeking by minimizing the opportunities for theft and corruption. Countries like Botswana and Trinidad and Tobago are examples of countries that have been successful in this way. The international community can also provide technical assistance on how to manage the windfalls to minimize macroeconomic volatility and reduce the Dutch Disease effects.

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Appendix

Table 1

Group of countries	Baltic	Balkan	Visegrad	Asia	BUR	CEE	CIS
GDP per capita in 2010 (constant 2000 USD)	5,480.26	2,695.03	8,074.49	1,371.36	2,241.30	5,213.10	1,548.39
Real GDP per capita in 2010 (% change from 1991)	0.50	0.55	0.77	0.44	0.33	0.76	0.39
GDP growth (average annual % change over 2008-2010)	-5.58	1.43	0.26	4.78	1.34	-0.49	3.96
Gini index of inequality	35.85	32.56	32.36	32.45	31.21	33.33	32.90
2010 EBRD Transition Indicators (average of 9 indicators)	3.89	3.50	3.67	2.79	2.56	3.64	2.64
2010 Transparency International Corruption Perception Index	5.27	3.62	5.06	2.38	2.33	4.49	2.28
2010 World Bank Worldwide Governance Indicators (average of Government Effectiveness and Rule of Law)	0.79	-0.19	0.83	-0.74	-0.82	0.35	-0.84

Arithmetic averages were used. Gini indexes are for years 2003 (Armenia, Bulgaria, Georgia, Kazakhstan, Macedonia, and Uzbekistan), 2004 (Albania, Baltic countries, Croatia, Hungary, Kyrgyz Republic, Moldova, Poland, Slovenia, and Tajikistan), 2005 (Azerbaijan, BUR, and Romania) and missing for Czech Republic, Slovak Republic, and Turkmenistan.

Sources: World Bank World Development Indicators unless otherwise stated.

Definitions: Baltic (Estonia, Latvia, Lithuania), Balkan (Albania, Bulgaria, Moldova, Romania, Croatia, Macedonia), Visegrad (Czech Republic, Slovak Republic, Poland, Hungary, Slovenia), Asia (Armenia, Azerbaijan, Georgia, Kazakhstan, Uzbekistan, Kyrgyzstan, Turkmenistan, Tajikistan), BUR (Russia, Belorussia, Ukraine), CEE (Baltic, Balkan, Visegrad), CIS (BUR, Asia except Georgia). This grouping is taken from Campos and Coricelli (2002) and has been kept unaltered to simplify comparisons, although some countries in the Balkans are missing.

Table 2

Group of countries	Baltic	Balkan	Visegrad	Asia	BUR	CEE	CIS
GDP per capita in 1990 (constant 2000 USD)	4,004.72	2,139.53	5,240.18	996.59	1,799.54	3,646.59	1,150.26
Share of industry in GDP in 1990 (%)	44.67	45.00	49.80	39.63	47.00	46.64	41.09
Overindustrialisation (difference between actual and predicted industrialization, % of GDP)	10.00	10.00	12.20	4.13	7.67	10.79	4.64
Urbanization in 1990 (% of total population)	70.33	54.33	61.60	48.88	69.00	60.36	53.55
Gross school enrolment rate (basic education) in 1990	94.70	90.65	97.68	92.96	92.80	94.34	92.88
Life expectancy at birth for males in 1990 (years)	65.13	67.89	67.04	65.99	65.23	66.69	65.61
Gini index	22.65	23.42	22.90	25.77	23.29	23.01	23.99

Arithmetic averages were used. Gini indexes are for years 1987 (Slovenia), 1988 (Asia, Baltic countries, BUR, Croatia, Czech Republic, Slovak Republic, and Moldova), 1989 (Bulgaria, Hungary, Poland, and Romania) and missing for Albania, Macedonia, and Asian countries except for Kazakhstan, Kyrgyz Republic, Turkmenistan, and Uzbekistan.

Sources: Campos and Coricelli (2002), De Melo et al. (2001), and World Bank World Development Indicators.

Table 3

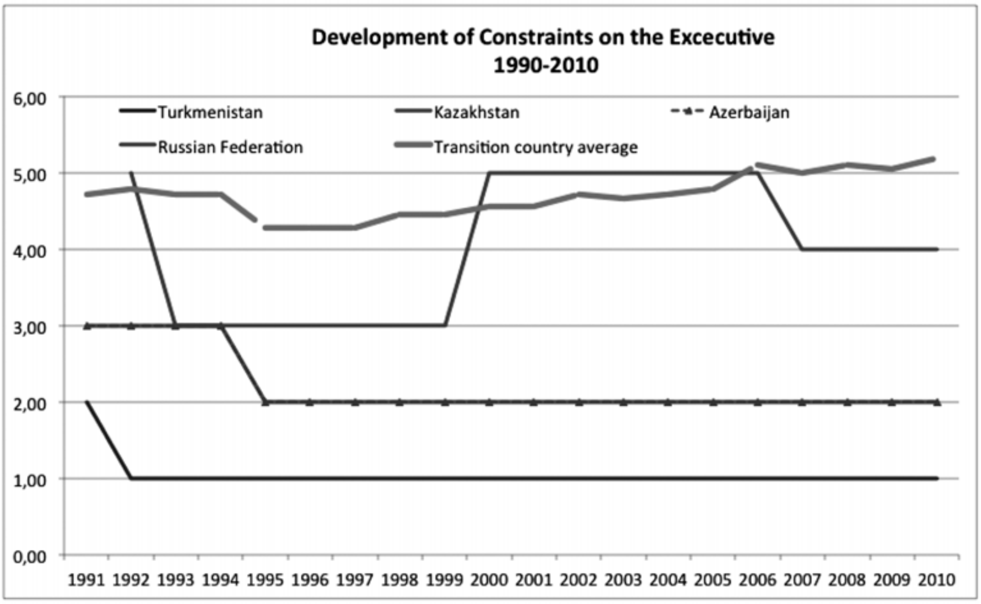
Country	Algeria	Egypt	Jordan	Lebanon	Libya	Morocco	Syria	Tunisia
GDP per capita in 2009 (constant 2000 USD)	2,186.28	1,957.08	2,512.49	6,350.47	7,885.47	1,800.67	1,485.73	2,803.26
Share of industry in GDP in 2008 (%)	62.12	37.53	32.64	21.16	78.20	30.32	35.03	32.14
Urbanization in 2010 (% of total population)	66.50	42.80	78.50	87.20	77.90	56.70	54.90	67.30
Gross school enrolment rate (basic education)	96.48	67.20	88.22	82.14	93.48	55.85	74.74	90.21
Life expectancy at birth for males in 2009 (years)	71.19	70.86	71.81	70.12	72.03	69.39	74.07	72.50
Gini index	35.33	32.14	37.72			40.88	35.78	40.81

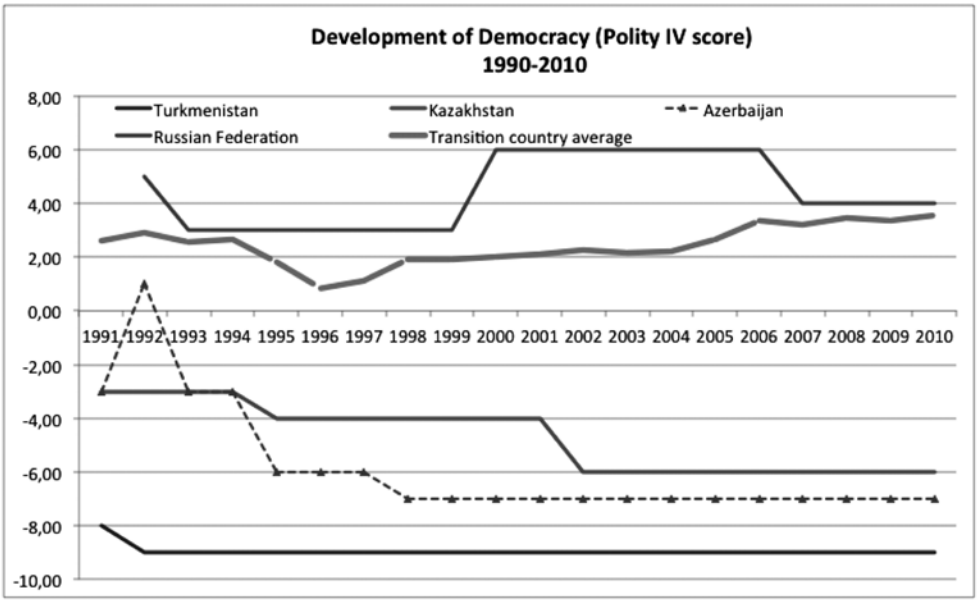
Gini indexes are for years 1995 (Algeria), 2000 (Tunisia), 2004 (Egypt and Syria), 2006 (Jordan), and 2007 (Morocco).
Sources: World Bank World Development Indicators.

Table 4: Group and country comparisons of gender equality

Group/country	Female labor force participation	Share female MPs	Health spending over GDP
World	51.7	19.3	10.0
Arab World	26.4	10.7	4.6
Sub-Saharan Africa	61.0	19.4	6.6
Egypt	22.4	1.8	5.0
Tunisia	25.6	27.6	6.2
Libya	24.7	7.7	3.9
Turkey	24.0	9.1	6.7

Sources: World Bank Indicators, http://data.worldbank.org.


Development of Constraints on the Excecutive
1990-2010
Turkmenistan
Kazakhstan
Azerbaijan
Russian Federation
Transition country average
6,00
5,00
4,00
3,00
2,00
1,00
0,00
1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010


Development of Democracy (Polity IV score)
1990-2010
Turkmenistan
Kazakhstan
Azerbaijan
Russian Federation
Transition country average
8,00
6,00
4,00
2,00
0,00
-2,00
-4,00
-6,00
-8,00
-10,00
1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010