American University of Beirut
Institute of Financial Economics

Lecture and Working Paper Series No. 2, 2004

The Politics of Sustaining Growth in the Arab World: Getting Democracy Right[1]

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The World Bank

1. An earlier version of this paper was presented at the sixth international conference of the Middle East Economic Association (MEEA) on "The Economics and Finance of the Middle East and North Africa," Byblos, Lebanon, May 27–29, 2004. The views expressed in this paper are not necessarily those of the World Bank, its Board of Directors or affiliated organizations. The author would like to acknowledge the excellent research support by Gary Milante and Linda Kaltani. He is also grateful, without implications, to Samir Makdisi for helpful comments.
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Abstract

Arab growth has been both unsustainable in the long run as well as characterized by high short run volatility, especially in the period affected by the massive oil price shocks since 1985. This paper seeks to explain these two devastating features of the region's growth. Our analysis corroborates the view, most notably articulated in the work of Dani Rodrik, that this phenomenon is not just a failure of adjustment policy in the technical sense. The lack of sustainability of Arab growth, our evidence suggests, is in fact a symptom of a much deeper phenomenon, reflecting the interactive effects of the susceptibility to large shocks, the relatively high degree of "latent" conflicts in several Arab societies and the limited institutional capacity for resolving social conflicts due to the appalling standards of democracy in the region. The latter motivated the second pivotal question addressed in this paper, which asks why the region has lacked the right political institutions for sustaining growth. Drawing on the insight of a recent work on determinants of democracy in the Arab world (Elbadawi and Makdisi, 2003), which emphasizes the role of intra- and inter-state wars and oil dependency in explaining the "freedom deficit" in the Arab world, this paper argues that "getting democracy right"(i.e. real and robust democratic transformations) would require resolution of the violent conflicts afflicting the Arab world today. Moreover, the paper draws out the implications of the recent American-sponsored Greater Middle East Initiative, claimed to be aimed at promoting democracy and development, but believed to have been deliberately silent on addressing the Arab-Israeli conflict.

Introduction

Economists have recently started to distinguish between the requirements for *igniting* and *sustaining* growth. Dani Rodrik (2003), for example, has argued that these two aspects of growth appear to be driven by two different processes. While launching the economy into a growth path for a few years, as challenging as it is, may only require identifying and addressing the most serious constraints facing the private sector or capital accumulation; sustaining growth can be a much more complex process. According to Rodrik, sustaining growth-promoting policies would require broad-based institutional capabilities for mediating potentially conflictive interests among social groups, especially in the aftermath of exogenous shocks to the economy. This literature argues, therefore, that the larger the shocks and the deeper the conflictive interests or preferences in the society affected by these shocks, the more challenging the task of maintaining growth-promoting policies in the long run is likely to be. The role of robust institutions in this case is critical, especially political institutions for promoting grand bargains among social groups in a context of a national development strategy or a social contract (Rodrik, 1997, 1998a). A related strand of the literature emphasizes the view that a society's choice of inefficient policies and institutions is more a reflection of the interests of the social groups holding on to power rather than due to differences in ideology. Moreover, this literature suggests that kleptocratic policies are more likely under certain conditions, including when societies are divided, rulers have

access to substantial resources from aid or natural resources, or when political institutions are weak (e.g., Acemoglu, 2002; Acemoglu, Robinson, and Verdier, 2003). This paper focuses on the difficulty of sustaining growth in the 22 Arabic-speaking member countries of the League of the Arab States (hereafter the Arab world).[1] I characterize lack of sustainability of growth by the combined features of long-term instability and short-term volatility of growth.

Though the Arab world grew at a relatively fast rate (at a per capita rate of more than 3% per annum) for a quarter century (1960–84); growth in the region has, however, slowed down quite considerably (to about 1% per annum) for the following decade since 1985 (Table 1). This period was characterized by significant slumps in the price of oil, the driving force of the region's growth. The disappointing growth performance of the Arab world has not only complicated the already serious economic and social crisis created by the region's massive youth unemployment, but also threatened earlier social development gains achieved during the earlier high growth period (World Bank, 2003). It is not surprising, therefore, that restoring growth has emerged as the top development agenda for the region.[2]

Figure 1 provides an overall view of the instability of growth in the median Arab country relative to the rest of the world. It is clear that growth

1. Since its inception in 1945, the League of the Arab States (LAS) has been mainly a political grouping of countries with a common cultural and historical heritage. But economic integration has also been high in the agenda, despite the failure of the League to transform the region into a viable economic grouping (for an analysis of the problems and prospects of Arab economic integration, see Galal and Hoekman, 2003).

2. Elbadawi (2004) accounts for the slowdown of long-term growth in the Arab world, focusing on traditional growth fundamentals as well as Arab region-specific variables. See also UNDP, 2002; World Bank, 1995, 2003; Dhonte, Bhattacharya and Yousef, 2000; Makdisi, Fattah and Limam, 2000; for analysis of growth performance in the Arab world.

in the Arab world has always been very volatile throughout the last 40 years or so, especially in 1985–94. During this period growth volatility (measured by the ratio of the standard deviation of growth over the absolute value of its mean) averaged 4%, which is almost double the average volatility for the first period. Instead, an already very low growth volatility in East Asia declined from 0.6 to 0.3%. However, in the third period, which witnessed the 1996 Asian crisis, Asian growth volatility rose considerably to reach more than 2%, comparable to African growth volatility. An important consideration in the analysis of growth in the Arab world is the diversity of the region. Despite their common cultural and historical heritage, Arab countries have very diverse characteristics in such key areas as the structures of the economies, level of development, geographic location, and type of governance and institutions. Therefore, Table 1 disaggregates the Arab world into high, middle and low income Arab economies. Similar to the overall median performance of the region, all three groupings appear to having experienced relatively high growth volatility, especially during the post 1985 period. Moreover, unlike East Asia, which managed to sustain high average growth rates for almost 40 years, growth in the Arab world has substantially decelerated since 1985, and for the low income Arab countries it has essentially collapsed.

The evidence, therefore, suggests that Arab growth has been both unsustainable in the long run as well as characterized by high short run volatility. This paper asks two key questions: What explains these devastating features of the region's growth and why has the region lacked the right political institutions for sustaining growth? The central framework for analyzing the first question follows Rodrik (1998a), who

proposes an interactive term (between the magnitude of external shocks, the degree of "latent" social conflict, and the standard of democracy) as a pivotal determinant of cross-country growth volatility and longer-term growth instability. The analysis of the second question draws from an empirical analysis of the determinants of democracy in the Arab world due to Elbadawi and Makdisi (2003), who emphasize the role of oil and regional conflicts in a modernity model of democracy.

Section two analyzes the determinants of long-run growth instability and short-term growth volatility for a sample of countries, covering most Arab countries. The estimated regressions are variants of the empirical model proposed by Rodrik. In this paper, I distinguish between fractionalization and polarization, as two alternative concepts for measuring "latent" social conflicts across countries. Moreover, using recent data developed by Alesina et al. (2003), I estimate the model for three types of social fractionalization and polarization, based on religion, ethnicity and language. In section three I undertake a detailed analysis of the shocks affecting the Arab world; the extent of cleavages in its societies and the standards of its democratic institutions. This section also assesses the relevance of the Rodrik's framework for explaining the near collapse and the increased volatility of growth following the major oil price shocks of the mid–1980s. Section four highlights the need for real and profound democratic transformation in the Arab world as a precondition for sustaining growth and reversing the legacy of growth instability and volatility. However, drawing from a recent analysis of determinants of democracy in the Arab world (Elbadawi and Makdisi, 2003), I argue in this section that the task of launching meaningful and sustainable democratic transformations in this region is particularly difficult. This is

because, as the above authors find, the high incidence of violent conflicts in the region and its high dependency on oil have been the main determinant of the Arab democracy deficit relative to the rest of the world. Therefore, I argue that it is critical to get democracy right in the Arab world. Drawing the implication of this analysis of the United States administration's envisaged Greater Middle East Initiative, which by design or negligence appears to have left out the overarching Arab-Israeli conflict, would suggest, just from this angle alone, that it is a nonstarter. Section five concludes.

Unsustainability of Growth: Shocks, Conflicts and Democracy?

As discussed above (Table 1), compared with the 1960s and 1970s, growth in the Arab world has significantly decelerated since 1985, which earmarked an extended episode of negative oil price shocks reversing its significant rise throughout most of the 1970s. Unsustainability of growth following external shocks appears to be a typical phenomenon in many countries in the developing world. In attempting to explain this phenomenon, Rodrik (1998a) argues that the effect of external shocks on growth and economic performance in general is not just the outcome of the failure of adjustment policy in the technical sense, but also reflects the interactions of these shocks with "latent" social conflicts in society on one hand, and with institutions for conflict management on the other. In societies with deep social conflicts and weak social or political institutions for conflict management, he argues, the economic costs of external shocks are magnified by the growth-retarding distributional conflicts that are triggered.[3]

3. He argues that the social conflicts could affect the response to external shocks in many ways: by delaying adjustment in fiscal policy and in key relative prices, most notably the real exchange rate; by generating increased uncertainty in the economic environment; and, by diverting recourses from productive to distributive activities.

To formalize this idea, Rodrik develops a model of social conflict arising from coordination failure, with two social groups acting independently and facing a shrinking pie as a result of an external shock. Depending on its prior opinion about how its rival group is likely to be "cooperative," each group must decide what share of the pie they will claim. In a conflictive society, each group will attach a high probability to an opportunistic grab of resources by its rival. Therefore, *ceteris paribus*, this game will result in higher claims than available resources, leading to distributional conflicts, which will, in turn, generate deadweight and the size of the pie shrinks further. On the other hand, the strength of conflict management institutions tends to moderate the potential inequities arising from asymmetric claims by the rules that govern the ex post distribution of resources. Therefore, this model suggests that the ex post distribution of resources is partly determined by the ex ante claims (social conflicts) and the pre-existing rules that govern basic rights and equitable entitlements across groups (social and political institutions).

Based on his theoretical model, Rodrik posited the following simple empirical framework:

(1)

$$\Delta\ growth = -\beta\ external\ shocks\ X\ \frac{latent\ social\ conflict}{institutions\ of\ conflict\ management} + \lambda'[growth\ convergence\ variables]$$

where the change in growth refers to longer-term persistence of growth, such as the change in the rate of per capita growth between 1985–94 and 1975–84, relevant to the Arab world. For short-term volatility of growth ($\sigma(growth)$) we use a similar but different framework based on the above concept of the interactive conflict variable.

The external shocks term is measured by the standard deviation of the first log-difference of the terms of trade multiplied by the average share of total trade in GDP in the initial period.[4] The empirical proxy for the ratio of "latent" social conflict to institutions of conflict management is given by an index of cleavages in a society multiplied by an index of lack of democracy.[5] The latter is measured by (10-Polity)/2, where Polity is a global index of the standard of democratic institutions. The Polity index is based on two concepts: *institutionalized democracy* and *institutionalized autocracy*. The DEMOC score is coded according to four main categories of regime characteristics: competitiveness of executive recruitment; openness of executive recruitment; constraints on the chief executive; and, competitiveness of political participations. And for the AUTOC score an additional category on "regulation of participation" is added as well. The POLITY score is computed by subtracting the AUTOC score from the DEMOC score; the resulting unified scale ranges from -10 (strongly autocratic) to 10 (strongly democratic).[6]

Social cleavages are measured by indexes of (ethnic, cultural or religious) fractionalization and polarization. The precise definitions of the social fractionalization-polarization indexes are as follows:

4. This measure captures the unexpected component of the volatility of the streams of income associated with foreign trade. Assuming that the terms of trade follow a random walk (possibly with a drift), Rodrik (1998b) shows that this measure is the theoretically appropriate measure of external volatility. Moreover, Rodrik argues that the fact that this measure treats equally positive terms of trade shocks and negative shocks is justified; since positive income shocks could also trigger the same kind of distributional conflicts that result from negative shocks.

5. The use of this proxy assumes that little or no democracy would suggest that there are no effective modalities for inter-social group bargaining; and that pre-existing rules for guaranteeing basic rights and equitable distribution among social and economic groups are either non-existent or cannot be systematically applied.

6. For a detailed description of these indices and data see, http://www.cidcm.umd.edu/inscr/polity/.

One measure of latent conflict is the index of fractionalization ($FRACT_j$) for country j, and given by:

(2)

$$FRACT_j = 1 - \sum_{i=1}^{N} s_{ij}^2$$

where is the share of group i (i=1, …,N) in country j. This index gives the probability that two randomly selected individuals from a population belonged to two different groups. This index was constructed by Alesina et al. (2003) for three types of fractionalizations: ethnic, language and religious.[7] This index reaches its maximum (at the value of 1) when each individual belongs to a different group. Most of the literature suggests that ethno-linguistic fractionalization is harmful to development. In addition to Rodrik, who finds ethnic fractionalization to be negatively associated with growth sustainability (as part of the conflict variable described above), Easterly and Levine (1997) find robust negative association between ethnic fractionalization and per capita growth. Also, other studies find the former to have negative impacts on governance and the quality of institutions (e.g., Canning and Fay, 1993; Mauro, 1995; and, La Porta et al., 1999). More recently, Alesina et al. (2003), using their new data, analyze the impact of each of the three fractionalization indexes on output growth and other measures of welfare as well as the quality of institutions and conclude that

7. Alesina et al. (2003) develop a more disaggregated and updated data than the one used to compute the well known ethno-linguistic fractionalization index (ELF), which lumps together language and ethnic background and was based on data collected in the 1960s. Instead, these authors disaggregated population shares according to language and ethnicity in addition to religion. They also report the entire distribution of the population of ethnic, language and religion for more than 180 countries.

"ethnic and linguistic variables, more so than religious ones, are likely to be important determinants of economic success" (*Journal of Economic Growth,* 182–83).

Another strand of the literatures argues that social polarization (POLAR) rather than fractionalization is the relevant concept for analyzing the impact of social conflict on development. The theoretical basis for this view is provided by Esteban and Ray (1994); and, Garcia-Montalvo and Reynal-Querol (2002) provide cross country evidence on the association between polarization and growth. They propose the following polarization index, which they show can be derived from a model of lobbying:

(3)

$$POLAR_j = 1 - \sum_{i=1}^{N} \left(\frac{0.5 - s_{ij}}{0.5}\right)^2 \; s_{ij}$$

where right hand side variables are as before. Note that this reaches a maximum when there are two equally sized groups in a society.

Long-Term Persistence of Growth. A version of model (1) above is estimated in tables 2 and 3 for a sample of 82 countries, including 21 from the Arab world. The conflict variable is used as a shorthand for the right-hand side multiplicative terms of equation 1 (Shock x FRAC x lack of democracy or Shock x POLAR x lack of democracy). In table 2 I used the social fractionalization variables for each of the three categories (ethnic, language, religion). I also used a fourth measure composed of the most dominant fractionalization for each country. A similar set of variables is used in table 3 where social polarization (POLAR) is used instead of

fractionalization. In addition to the conflict variable and its individual components, the regressions also control for per capita income at the initial period (1965–84) and growth at the initial period to capture convergence effects as well as the quality of economic institutions at the initial period, measured by the rule of law component of ICRG (see notes to table 2 for definitions of this and other variables).

Starting with table 2 the evidence suggests that the conflict variable was highly significant for the case of ethnic fractionalization and moderately significant for the cases of language, religious and dominant polarizations. And, in all cases, it was negatively associated with long-term stability of growth. Moreover, in the presence of the composite conflict variable, individual components are not significant except for the case of the shock variable in two out of five regressions. The convergence and the rule of law variables are all significant in three out of five regressions and are consistent with prior expectation. Good institutions for enforcement of property right (rule of law) are expected to enhance growth in the following period, while higher income or faster growth in the initial period should be associated with deceleration of growth in the future.

However, the results are much less robust for the case of the polarization-based conflict regressions (Table 3). While the conflict variable was significant for language polarization it was only marginally so for ethnic polarization. The religious and dominant polarizations-based conflict variables were not found to be significant. Overall the polarization-based regressions are weaker than their fractionalization-based ones. These results corroborate the view that for explaining economic performance, socially fractionalized societies are likely to experience more difficulty

forging consensus around the efficient economic policies and institutions for promoting growth than do polarized ones. In particular, our results corroborates the Alesina et al. (2003) findings that ethnic fractionalization is more robustly associated with growth than religious and language polarization. However, our evidence should not be taken to suggest that polarization is not a problem, because both ethnic and, especially, language polarization were negatively and significantly associated with long-term growth stability.

Short-term Growth Volatility. As discussed above, growth in the Arab world has also been subject to short-term volatility (Figure 1 and Table 1). Clearly shocks to terms of trade, most notably the price of oil, must have had direct effects on volatility of growth in the region. However, the above analytical model suggests that the direct effects of shocks tend to be magnified by social cleavages and inadequate capacity for conflict management. I estimate the determinants of short run growth volatility (measured by standard deviation of growth) in a model that accounts for the three components of the conflict variables and other controls affecting short-term volatility. In the light of the earlier results for long-term persistence of growth, I confine the analysis to social fractionalization. Moreover, I use the index of ethnic heterogeneity (EHET), which combines ethnic and language fractionalization. The regression results for a global sample of 128 countries, including 15 from the Arab world are reported in table 4. The results suggest that these variables are robustly associated with short-term growth volatility, where these variables are significant for both the Tobit and GLS regressions. Except for the volatility of financial depth, (measured as the standard deviation of the ratio of M2/GDP) volatility in other macroeconomic policy variables were not found to be significant.

Why has Sustaining Arab Growth Been So Difficult?

Before assessing the extent to which the conflict variable explains long-term instability and short-term volatility of growth in the Arab world, I compare the components of this variable in and outside the Arab world.

Shocks. Analysis of the shocks affecting the developing region suggests that Arab economies are susceptible to larger and more frequent shocks (Figure 2). This is not surprising given that oil constitutes the mainstay of the economies of about eleven member countries of the Arab League. Moreover, the economies of the remaining countries are very strongly linked to the former through the labor market, and to a lesser extent, economic assistance and investment. In particular, the average size of the shocks affecting the high income oil Arab economies is multiple times larger than those affecting any other groupings. For the middle income Arab countries there is no evidence that these countries are more susceptible to shocks than do the East Asians ones, though the size of the shocks affecting the latter was much smaller in the 1990s.[8] The exceptions are the relatively closed economies of the low income Arab group, which appear to be less susceptible to external shocks than all other groupings, including Sub-Saharan Africa.[9]

Social Fractionalization and Polarization. Tables 5 and 6, respectively, present the fractionalization and polarization indexes for 21 Arab countries as well as the medians for regional comparators. As a group the Arab world is clearly less fractionalized and less polarized compared to

8. However, in the 1990s decade the East Asian countries were much more profoundly affected by the shocks associated with the financial crisis.

9. However, these low income Arab countries are subject to much more devastating shocks, such as droughts, which will not be fully captured by this measure.

median world levels as well as East Asia and Africa, especially with regard to language and religion. However, though the Arab world is much less fractionalized overall, it does not seem to be significantly different in terms of ethnic fractionalization and polarization. Indeed, a more informative conclusion would emerge if we examine the data country by country. The country indexes make clear that there exist significant social cleavages in several countries. The point is more obvious if we examine the profiles of the most dominant type of fractionalization and polarization for each country. For example, several Arab countries have highly ethnically fractionalized societies (ethnic FRAC > 6), including Djibouti, Jordan, Mauritania, Somalia and Sudan; in addition, Lebanon, is characterized by high religious fractionalization (Figure 3). However, social polarization appears to be a more dominant feature of Arab societies (Figure 4). There are ten countries characterized by fairly extreme polarization (POLAR >7), including Kuwait, Iraq and Sudan (religious POLAR); Morocco, Mauritania, Jordan and Syria (ethnic POLAR); and, Bahrain, Djibouti and Algeria (Language POLAR). In addition, there are three more countries characterized by high polarization (POLAR > 6), including Qatar and Somalia (ethnic POLAR) and Lebanon (religious POLAR). And, two more countries (Oman and UAE) are characterized by moderate religious polarization (POLAR > 5).

The above evidence appears to be consistent with observed incidences of protest by marginalized social groups in several countries, including Iraq (the Kurds and Shi'a), the Sudan (southern and western provinces), the Gulf States and Saudi Arabia (the Shi'a), Syria (Sunnis vs. Alawites), Egypt (the Copts), and Algeria and Morocco (the Berbers). In a few cases these tensions scaled up into full-fledge civil wars, as in the cases

of Lebanon, Sudan, Iraq, and Algeria. In his assessment of the Arab political scene around the early 1980s, Saad Eddin Ibrahim states that, "parochialism and small traditions, i.e., societal 'dividers' that had always existed but remained temporary dormant, have again been triggered. Ethnic groups in the Arab world are launching a quest for self-assertion within their respective countries,"(1982, 172–73).

Since then the spread of civil conflicts may have somewhat narrowed, however, the impact of these cleavages on development policy, and hence growth and social welfare, is bound to be even more pervasive. Especially in light of the deplorable status of democracy in the region (as we will see below), internal social cleavages in the Arab countries can be a serious drag on its development.

Democracy. We consider the evidence from the widely quoted Polity IV index. According to this index the Arab world has consistently lagged behind the standard of democracy achieved by the rest of the world over the last 40 years or so, suggesting that (relative to the rest of the world) there is a persistent Arab democracy deficit. Moreover, this deficit has widened over time (Figure 5). In 1965 the Arab democracy deficit (relative to the rest of the world) equaled 3.8 points in the Polity scale (-10 to 10), which accounts for only 19% of the full range of 20 points reflecting the gap between fully-fledged democracy and extreme autocracy. Moreover, in 1965 the median regimes in the Arab and non-Arab developing world were both authoritarians, with Arab and non-Arab mean polity scores at –5.9 and –2.1, respectively. However, by 1999 not only did the gap widen to 10 points, which accounts for 50% of the full range of the Polity score, but the median non-Arab regime became democratic (with a mean Polity score of 3.8) while the median Arab regime remained not only autocratic, but the Polity score decreased to –6.1 in 1999.

Therefore, the Arab world is clearly undemocratic and because of its dependence on oil it has also been susceptible to shocks. Moreover, despite common religious, cultural, and historical heritage, there are, nevertheless, cleavages in most countries, including rather extreme ones in a few. It is clear that "conflict" in the sense of Rodrik is high in the Arab world, though mainly driven by susceptibility of its economies to large shocks and the applauding standards of its democratic institutions. In the light of the evidence on the role of conflict on sustainability of growth, it is not surprising that Arab growth both lacks long-term persistence and is characterized by short-term variability. Indeed, the conflict variable appears to be a very important factor behind the collapse of Arab growth in post 1985 period (Figure 6) as well as the high short-term volatility since the 1960s (Figure 7).

Getting Democracy Right: Regional Conflicts and Oil

On the premise that democracy is the ultimate institution for forging grand bargains and promoting consensus in a society, the above analysis, I would argue, has made a strong case for the centrality of real and profound democratic transformation in the Arab world for sustaining growth and reversing the legacy of growth instability and volatility. However, I would also like to argue that getting democracy right, (i.e., achieving meaningful and sustainable democratic transformations) is particularly difficult in this region under the prevailing conditions. This is because the high incidence of violent conflicts in the region (as well as its high dependency on oil) has been the main determinant of the Arab democracy deficit relative to the rest of the world (Elbadawi and Makdisi, 2003). Therefore, resolving the region's violent conflicts, especially the Arab-Israeli conflict and the violence precipitated by the

foreign military occupation of Iraq, must be part and parcel of any genuine and stable democratization process in the region.

Elbadawi and Makdisi (2003) provide a strong quantitative base for the widely held view within the Arab world about what the UNDP report characterized as the Arab world 'freedom deficit'. They, therefore, hypothesized that there must be a significant and negative Arab dummy in cross country models of determinants of democracy. To test their hypothesis they analyze the determinants of Polity IV, using a panel of 129 countries over eight five-year periods: 1960–99. The model accounts for a range of economic variables associated with the modernity theory of democracy (e.g., Lipset, 1959, 1994; Barro, 1996). In addition, their model also controls for three categories of variables suggested by the political science literature and related to a country's history, religion and social characteristics. They find that despite the strong empirical relevance of the basic modernity model and, to a lesser extent, the historical and social variables, there is still a negative and highly significant Arab dummy.

To unpack this persistent Arab dummy they identify the high incidence of regional conflicts and the heavy dependence on oil as two potential Arab region-specific factors that may have the potential of explaining the mystery of the Arab dummy. They use period average oil production by country and the percentage of countries in a region involved in inter-state or civil wars in a given period.[10] I state below abridged versions of the two "final" regressions from table 3 of Elbadawi and Makdisi:

10. However, unlike the oil variable the conflict variable is a regional variable, which is invariant to all countries in any given region. And there are six regions covered by Elbadawi and Makdisi's analysis: Arab world, SSA, South Asia, East Asia, Latin America and the Caribbean, OECD.

(4)

$$Polity\ IV = \beta'[modernity,\ history,\ and\ social\ variables] - 0.133^{***}.\ Arab\ Dummy - 0.004^{*}.\ Oil\ Production + 0.164^{**}\ Mean\ Quantity\ of\ Regional\ Wars$$

(5)

$$Polity\ IV = \beta'[modernity,\ history,\ and\ social\ variables] - 0.082^{NS}.\ Arab\ Dummy - 0.003^{*}.\ Oil\ Production + 0.336^{***}\ Mean\ Quantity\ of\ Regional\ Wars - 0.765^{***}.\ Mean\ Quantity\ of\ Regional\ Wars\ *\ Arab\ Dummy$$

where, the regressions are estimated with pooled Tobit, and *, ** and *** mean p-values <0.05; <0.01; and, 0.001. It is clear, therefore, that these effects are extremely significant. On the other hand, "NS" means insignificant effects.

The above two equations provide three very important findings. First, that dependence on oil is a drag on democracy. Second, that while conflicts tend to be associated with subsequent democratic transformations, the Arab region has been an exception. Though the marginal contribution of the conflict variable to the Polity index was positive (at about 0.34) everywhere outside the Arab world, its net marginal effect on democracy was actually negative (at – 0.43) (equation 5). Three, that the Arab dummy operates through the influence of conflict. This is because while the Arab dummy was highly significant in its own right (equation 4), it ceased to be so when controlling for the interaction term between conflict and the Arab dummy (equation 5). I would argue that this result is profound because it suggests a specific channel through which the Arab dummy operates. I briefly explain below why the findings of the above regressions make sense.

First, with regard to the more straightforward result on the corrosive effect of oil on democracy, the evidence is consistent with a wide range of literature on the subject (e.g. Eifert, Gelb and Tallroth, 2002). It is plausible to argue that the immense oil resources commanded by several Arab countries have either facilitated the emergence of repressive militaristic regimes in some and non-democratic traditional authoritarian regimes in others. Furthermore, the control of a handful of countries in the Gulf (mostly small nations) of the largest share of the global oil reserves ensures tremendous presence of foreign influence, which by and large, has not been in favor of democratization.[11]

Second, for the case of the impact of military conflicts on democracy recent experiences seem to corroborate our findings. All cases where inter-state wars led to transitions from dictatorship to democracy are outside the Arab world. The two most notable examples of democratic transformations (both associated with defeat of a ruling military junta) are Pakistan following the war with India in the 1960s, and Argentina following the Falkland's war in the early 1980s. However, over the last 40 years several Arab regimes lost major wars, yet they continue to hold on to power. The Arab-Israeli conflict and the perceived adversarial global power interventions in the region have provided potent arguments for an authoritarian brand of Arab nationalism for most of the last fifty years or so (e.g., Ibrahim,1982; chapter 7). As such, political and civil liberties were violated, in many cases very egregiously, and military coups were mounted in the name of Arab nationalism and Palestine.

11. In addition to Ibrahim (1982), who provides a penetrating perspective on oil and the new Arab social order, see also Alnasrawi (1991) on Arab nationalism, oil and the political economy of dependency.

I would like to conclude by drawing the implications of this finding for the current debate on how to democratize the Arab world, most notably the United States administration-inspired Greater Middle East Initiative. According to some recent literature (e.g., Ottaway and Carothers, 2004) the plan has not been formally launched, nevertheless, its main elements have started to emerge. Claimed to have been built on the diagnosis of the 2002 Arab Human Development Report, the central priorities of the plan are threefold: promoting democracy and good governance, building a knowledge society, and expanding economic opportunities.

While these priorities are ideals that most sensible people, including the Arabs, would embrace, the important issue, however, is what the plan does not include. Ottaway and Carothers make the following very fundamental points:

> When the idea of a Greater Middle East Initiative was first raised last autumn, some US policy makers envisaged a Helsinki Process[12] for the region, interpreting Helsinki, misleadingly, simply as a pointed focus on human rights and democracy.
>
> The administration was in fact determined to keep security issues off the table, knowing well that the Arab countries would immediately insist on raising the Arab-Israeli conflict, which the administration did not want to put into the mix. As a result, the Helsinki analogy was quickly dropped (*Policy Brief* 29, 2, 3).

12. The Helsinki process was launched in 1972 to promote reciprocity and continuous engagement between the former Soviet Union, the United States and western Europe.

I would argue that in the light of the above analysis the Greater Middle East Initiative is clearly a nonstarter because it has simply chose to ignore the fundamental reality regarding the role of conflicts in explaining why the region is not democratic. To be sure, a complex process like democratic transformation requires, among other things, ownership within the region. However, and not withstanding the above critical consideration, it is clear that the Greater Middle East Initiative, or any other external initiative, aimed at promoting democracy and development in the Arab world, must make resolution of violent conflicts, most notably the Arab-Israeli conflict, as the cornerstone of its strategy.

Conclusions

After a quarter century of respectable performance, economic growth in the Arab world slowed down to almost a grinding halt since the mid 1980s, following the major collapse of oil prices. Though in the second half of the 1990s the region has started to show some signs of recovery, it remains, however, a hesitant recovery and a far cry from the stellar growth performance of the earlier period. Moreover, the region's growth has been rather volatile, especially in the decade following the oil price shocks of the 1980s. Therefore, Arab growth has been both not persistent in the long run and highly volatile in the short run.

Recent growth literature, most notably the work of Dani Rodrik, has emphasized the distinction between igniting and sustaining growth and argued that the latter is more demanding and would require broad-based institutional capacity for maintaining growth-promoting policies in the longer run. Failure to institutionalize and maintain such policies following

external shocks, Rodrik argues, is not just a failure of adjustment policy in the technical sense. It is in fact a symptom of a much deeper phenomenon, reflecting the interactive effects of the size of shocks, the extent of "latent" conflicts in a society and the quality of the institutions of conflict management. The analysis of this paper corroborates an empirical version of the Rodrik's model, with the central variable explaining both longer run persistence and short-term volatility of growth given by the interactive term 'conflict'(equal to: terms of trade shocks x social fractionalization or polarization x index of lack of democracy).

Our analysis, which distinguishes between three aspects of social fractionalization (or polarization) along religious, ethnic, and language lines, finds conflict-based fractionalization, especially ethnic fractionalization, to be more robustly associated with growth performance. This paper's analysis also suggests that a combination of high social fractionalization and polarization in many Arab countries; high susceptibility of these economies to shocks, especially in the large oil producers; and, the appalling standards of democracies in the Arab world have all been at work to generate a high Arab conflict variable in the sense of Rodrik. Not surprising, the lack of long-term persistence and short term volatility of Arab growth appears to be substantially accounted for by this variable and its three components.

Having addressed the first pivotal question as to what explains these two unpleasant features of the Arab region's growth; the paper then asks the other equally critical question as to why the region has lacked the right political institutions for sustaining growth.

The analysis of this second question draws insights from research on the determinants of democracy in the Arab world (Elbadawi and Makdisi 2003).

This work emphasizes the role of oil and regional conflicts in explaining the highly publicized "Arab freedom deficit" coined by the UNDP Arab Human Development Report of 2002. The findings of the above authors suggest three conclusions. First, that the Arab oil dependency has been a drag on the region's democracy. Second, that while inter-state wars and other violent conflicts usually lead to democratic transformation, the Arab region has been an exception. Three, that the Arab world is different because of the peculiar influence of regional wars on democracy in the region. Drawing on the insight of this analysis the paper argues that resolving the region's violent conflicts, most notably the Arab-Israeli conflict and the violence triggered by the foreign occupation of Iraq, would promote the cause of democracy in the region. Moreover, it is very unlikely that a wide and robust process of democratization will sweep the Arab world with the current pervasive violence in the region. This analysis has direct implication for the United States administration-sponsored Greater Middle East Initiative. The initiative was claimed to be aiming at promoting democracy and development, but judged to have been deliberately silent on addressing the Arab-Israeli conflict. This paper has therefore argued that this initiative, which is yet to be formally launched, is likely to be an exercise in futility if it turned out, as expected, to be devoid of any explicit processes for resolving the Palestinian question and to the overall Arab-Israeli conflict.

Table 1 Percentage of Growth Performance in the Arab World

	1960–84		1985–94		1995–2000	
	Growth	Growth Volatility	Growth	Growth Volatility	Growth	Growth Volatility
High Income	5.5	2.1	1.0	4.0	0.8	1.3
Bahrain	5.5	2.8	1.5	4.0	1.6	1.3
Kuwait	-6.6	1.5	4.5	9.8	-3.2	1.2
Libya	13.0	1.4	1.4	6.8	13.6	0.5
Oman	8.3	2.0	1.0	4.0	0.8	2.2
Qatar	12.4	2.4	0.6	19.3	21.6	0.4
Saudi Arabia	3.2	2.1	-1.3	3.8	-1.0	1.8
United Arab Emirates	-4.3	2.3	-4.4	2.1	-1.4	5.1
Middle Income Countries without Algeria	3.1	2.0	1.4	3.3	0.8	3.4
Middle Income Countries with Algeria	2.8	2.5	1.4	2.7	1.3	1.7
Algeria	1.9	5.4	-2.1	1.0	1.6	0.9
Egypt Arab Republic	3.6	0.9	1.6	1.0	3.1	0.2
Jordan	2.5	3.0	-2.0	3.9	0.3	5.1
Lebanon	-	-	1.3	24.2	1.3	1.7
Morocco	2.0	2.0	1.9	2.7	0.1	69.7
Syrian Arab Republic	3.1	3.0	1.4	4.9	0.3	13.3
Tunisia	3.6	1.1	1.4	2.2	3.6	0.4
Low Income	1.7	18.0	-1.5	4.4	1.2	0.8
Comoros	0.41	18.03	-1.32	2.97	-1.06	1.69
Djibouti	-	-	-7.0	0.3	-2.2	0.8
Mauritania	1.7	4.3	0.4	5.4	1.2	0.8
Sudan	-0.17	34.39	1.2	5.5	3.8	0.1
Yemen Republic	-	-	-1.5	4.4	3.4	0.7
Arab World	3.2	2.1	1.2	4.0	0.8	1.3
East Asia	4.3	0.6	5.2	0.3	2.9	2.2
Sub-Saharan Africa	1.1	3.5	-1.1	1.8	0.3	2.3

Sources: *World Development Indicators* (The World Bank, 2003), *World Development Index 2003,* and Summers & Heston

Notes:

1. Country-specific growth rates are the period averages of GDP per capita growth.
2. Regional/Type growth rates are the median of average country growth rates.
3. Country-specific growth volatilities are measured as the ratio of standard deviation over the absolute value of the mean.
4. Regional/Type volatilities are the median of country volatilities.
5. The countries representing East Asia are Indonesia, Malaysia, Singapore, South Korea, Thailand.
6. The countries representing Sub-Saharan Africa are Burkina Faso, Botswana, Côte d'Ivoire, Republic of Congo, Ghana, Gambia, Kenya, Madagascar, Malawi, Niger, Nigeria, Senegal, Sierra Leone, Togo, South Africa, Democratic Republic of Congo, Zambia, Zimbabwe.

Table 2 Growth and Fractionalization
Dependent Variable: Change in Mean Growth of GDP per Capita, 1985–94 vs. 1965–84

	(1)	(2)	(3)	(4)	(5)
Growth (1965–84)	-0.857	-0.781	-0.821	-0.890	-0.876
	(-5.94)	(-5.66)	(-5.77)	(-6.16)	(-6.18)
Income (1984)	-0.002	-0.005	-0.005	-0.004	-0.005
	(-0.91)	(-2.18)	(-2.09)	(-1.41)	(-1.97)
Rule of Law	0.004	0.005	0.006	0.005	0.006
	(1.46)	(2.02)	(2.28)	(1.88)	(2.13)
Lack of Democracy	-0.001	0.00002	6.44E-06	-0.001	-0.001
	(-0.74)	(0.02)	(0.01)	(-1.00)	(-0.48)
Shock	-0.118	0.016	-0.008	-0.144	-0.066
	(-2.67)	(0.24)	(-1.46)	(-2.08)	(-0.88)
Ethnic Fractionalization		-0.002			
		(-1.58)			
Conflict (Ethnic)		-0.030			
		(-2.12)			
Language Fractionalization			-0.0008		
			(-0.76)		
Conflict (Language)			-0.0212		
			(-1.75)		
Religious Fractionalization				-0.002	
				(-1.74)	
Conflict (Religion)				0.008	
				(0.46)	
Dominant Fractionalization					-0.003
					(-1.82)
Conflict (Dominant)					-0.011
					(-0.74)
Constant	0.012	0.030	0.025	0.027	0.038
	(0.68)	(1.42)	(1.27)	(1.34)	(1.59)
R2	0.33	0.43	0.42	0.36	0.39
F	7.58	8.06	7.53	6.01	6.73
Number of Observations	82	82	80	82	82

Notes:

1. The dependent variable, change in mean growth of GDP per Capita, 1985–94 vs. 1965–84, is calculated by determining the mean number of growth in each period and subtracting the latter from the former. (WDI, 2004)
2. Growth (1965–84) is simply the base level of growth in GDP per Capita for those years. (WDI, 2004)
3. Income (1984) is the base level of income per capita as of 1984. (WDI, 2004)
4. Rule of Law is the ICRG measure of Rule of Law compiled by Kaufman and Kraay (2002), standardized to a scale of 1 to 10.
5. Lack of Democracy = (10-Polity)/2 to invert and standardize the polity score on a scale of 1 to 10.
6. SHOCK = SD[ln(Terms of Trade$_{1980–1989}$)] x Openness$_{1965–1984}$ (*UNCTAD Handbook of International Trade*, 2001)
7. Fractionalization and polarization calculated and standardized (1 to 10) Alesina et al. (2003) data set.
8. t statistics are in parentheses.

Table 3 Growth and Polarization
Dependent Variable: Change in Mean Growth of GDP per Capita, 1985–94 vs. 1965–84

	(1)	(2)	(3)	(4)	(5)
Growth (1965–84)	-0.857	-0.876	-0.782	-0.805	-0.832
	(-5.94)	(-6.04)	(-5.43)	(-5.32)	(-5.56)
Income (1984)	-0.002	-0.002	-0.004	-0.003	-0.003
	(-0.91)	(-0.61)	(-1.75)	(-1.14)	(-1.05)
Rule of Law	0.004	0.004	0.006	0.003	0.003
	(1.46)	(1.64)	(2.18)	(1.27)	(1.20)
Lack of Democracy	-0.001	0.001	0.0004	-0.001	-0.001
	(-0.74)	(0.43)	(0.4)	(-1.34)	(-1.06)
Shock	-0.118	0.011	-0.055	-0.210	-0.183
	(-2.67)	(0.11)	(-1.03)	(-2.69)	(-1.90)
Ethnic Polarization		0.0002			
		(0.13)			
Conflict (Ethnic)		-0.032			
		(-1.55)			
Language Polarization			0.001		
			(0.83)		
Conflict (Language)			-0.036		
			(-2.65)		
Religious Polarization				-0.001	
				(-1.01)	
Conflict (Religion)				0.020	
				(1.42)	
Dominant Polarization					-0.001
					(-0.44)
Conflict (Dominant)					0.013
					(0.77)
Constant	0.012	-0.004	0.010	0.031	0.027
	(0.68)	(-0.16)	(0.53)	(1.36)	(0.98)
R2	0.3329	0.355	0.4206	0.351	0.338
F	7.58	5.82	7.46	5.72	5.41
Number Observations	82	82	80	82	82

Notes:

1. Variables are calculated and sourced as per those presented in Table 2.
2. t statistics are in parentheses.

Table 4 Democracy and Sustainable Growth
(Dependent Variable: Standard Deviation of Percentage Change in per Capita GDP)

	Tobit Estimation	GLS Estimation
	(1)	(1')
Shock*ehet	0.001	0.001
	(3.91)**	(3.09)**
Shock*ehet*polity	-0.0002	-0.000
	(3.77)**	(3.09)**
Standard deviation	-0.000	-0.000
of government expenditures	(0.96)	(0.39)
Standard deviation	-0.000	0.000
of investment	(0.50)	(0.11)
Standard deviation	-0.000	0.000
of inflation	(1.12)	(0.59)
Standard deviation	0.001	0.002
of money supply (M2/GDP)	(2.07)*	(2.25)*
Constant	0.031	0.026
	(13.82)**	(7.18)**
Observations	420	420
R-squared		0.30
Number of observations		88

Notes:
1. The regressions are based on 128 countries including the following Arab countries: Algeria, Bahrain, Egypt, Jordan, Kuwait, Mauritania, Morocco, Oman, Saudi Arabia, Sudan, Syria, Tunisia, United Arab Emirates, and Yemen.
2. The standard deviations are derived over 5-year periods for the years 1960–99.
3. The median values for Ethnic Heterogeneity (EHET) are as follows: GCC: 21.96; Mixed oil economies: 5.46; Diversified oil economies: 27.04; Primary producing economies: 30.96.
4. Absolute value of t statistics in parentheses.

* significant at 5%; ** significant at 1%

Table 5 Social Fractionalization in the Arab World

	Ethnic	Language	Religion	Dominant Category*
Algeria	0.320	0.443	0.009	0.443
Bahrain	0.502	0.434	0.553	0.553
Djibouti	0.796	0.656	0.043	0.796
Egypt	0.184	0.024	0.198	0.198
Iraq	0.369	0.369	0.484	0.484
Jordan	0.593	0.040	0.066	0.593
Kuwait	0.233	0.000	0.481	0.481
Lebanon	0.131	0.131	0.789	0.789
Libya	0.058	0.076	0.057	0.076
Mauritania	0.615	0.326	0.015	0.615
Morocco	0.484	0.468	0.003	0.484
Oman	0.102	0.000	0.269	0.269
Qatar	0.320	0.000	0.000	0.320
Saudi Arabia	0.180	0.000	0.067	0.180
Somalia	0.812	0.033	0.003	0.812
Sudan	0.715	0.719	0.400	0.719
Syria	0.395	0.182	0.431	0.431
Tunisia	0.039	0.012	0.010	0.039
United Arab Emirates	0.276	0.000	0.276	0.276
Yemen	0.008	0.008	0.002	0.008
Arab Median	0.320	0.058	0.067	0.320
East Asian Median	0.450	0.616	0.549	0.616
Sub-Sahara African Median	0.738	0.783	0.633	0.783
World Median	0.415	0.335	0.461	0.461

Notes:
1.Fractionalization values for the GCC countries (Kuwait, Libya, Oman, Qatar, Saudi Arabia) were adjusted to exclude guest workers from the population. Moreover, ethnic fractionalization values for the United Arab Emirates were adjusted to match the values for religious fractionalization since almost all Shi'a Muslims are of Iranian ethnicity. Also, ethnic fractionalization for Yemen is reported equal to linguistic fractionalization due to lack of ethnicity data.
2. Index range between zero and one and it is based on equation two in the text.
* Represents each country's highest value among the three categories (ethnicity, language, religion).

Table 6 Social Polarization in the Arab World

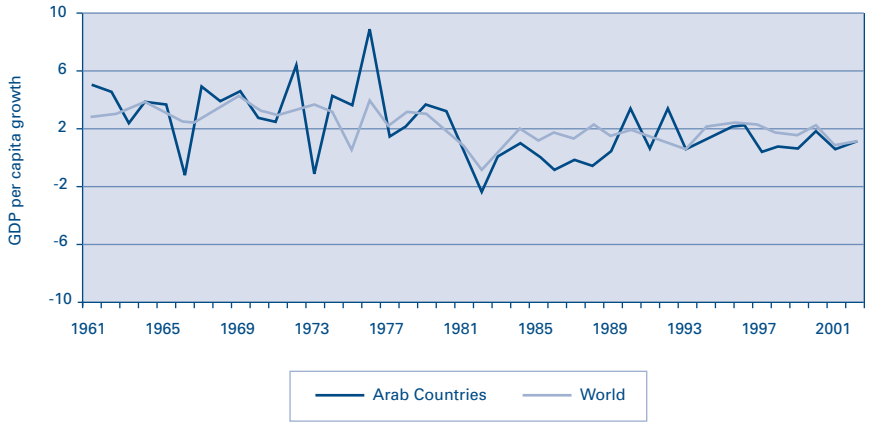
	Ethnic	Language	Religion	Dominant Category*
Algeria	0.640	0.720	0.018	0.720
Bahrain	0.851	0.869	0.826	0.869
Djibouti	0.608	0.838	0.087	0.838
Egypt	0.365	0.047	0.385	0.385
Iraq	0.664	0.663	0.893	0.893
Jordan	0.892	0.078	0.132	0.892
Kuwait	0.466	0.000	0.962	0.962
Lebanon	0.256	0.255	0.618	0.618
Libya	0.116	0.148	0.114	0.148
Mauritania	0.906	0.523	0.030	0.906
Morocco	0.959	0.885	0.007	0.959
Oman	0.205	0.000	0.539	0.539
Qatar	0.640	0.000	0.000	0.640
Saudi Arabia	0.360	0.000	0.134	0.360
Somalia	0.624	0.065	0.006	0.624
Sudan	0.650	0.630	0.774	0.774
Syria	0.592	0.354	0.647	0.647
Tunisia	0.078	0.025	0.021	0.078
United Arab Emirates	0.552	0.000	0.552	0.552
Yemen	0.016	0.016	0.005	0.016
Arab World Median	0.616	0.113	0.133	0.661
East Asia Median	0.680	0.652	0.719	0.719
Sub-Saharan Africa	0.628	0.565	0.769	0.769
World Median	0.603	0.491	0.706	0.706

Notes:

1. Polarization values for the GCC countries (Kuwait, Libya, Oman, Qatar, Saudi Arabia) were adjusted to exclude guest workers from the population. Moreover, ethnic polarization values for the United Arab Emirates were adjusted to match the values for religious polarization since almost all Shi'a Muslims are of Iranian ethnicity. Also, ethnic polarization for Yemen is reported equal to linguistic polarization due to lack of ethnicity data.
2. Index range between zero and one and is based on equation three in the text.

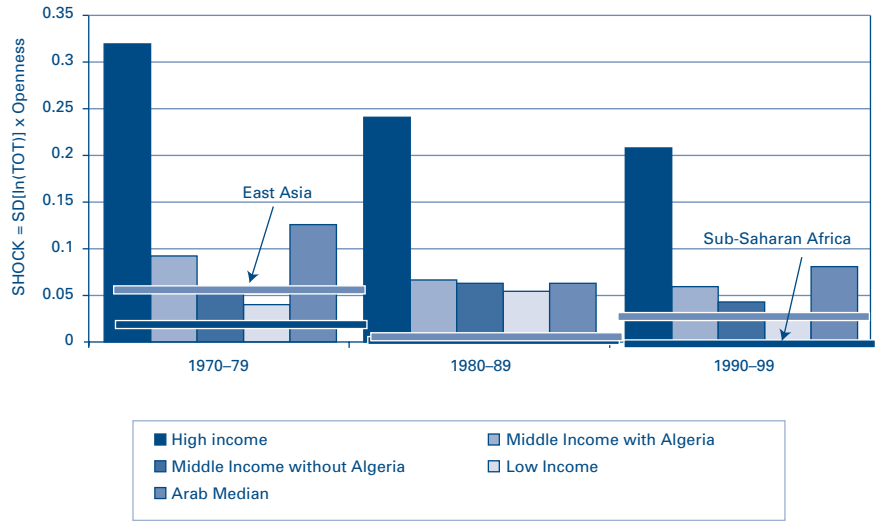
* Represents each country's highest value among the three categories (ethnicity, language, religion).

Figure 1 Growth Performance 1961–2002



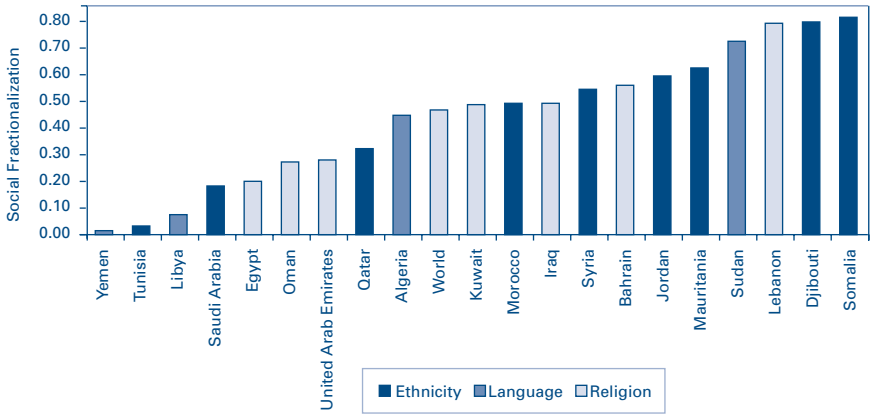
Source: World Development Indicators 2003. World Bank Data Base.

Figure 2 Median Terms of Trade Shocks by Type and Period



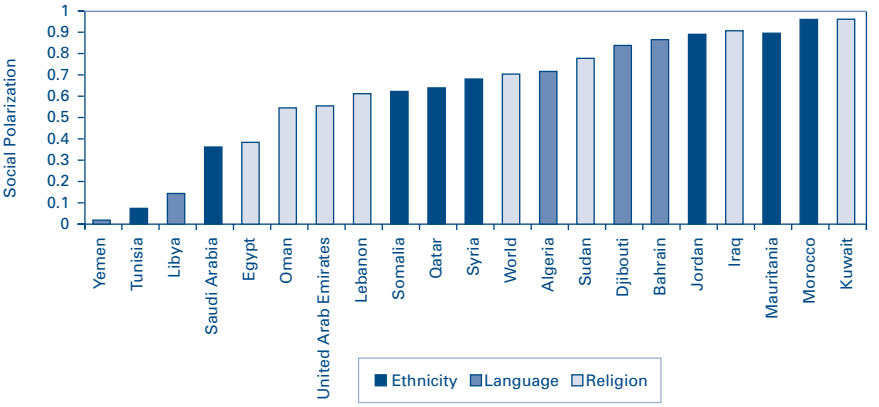
Source: World Development Indicators 2003. World Bank Data Base.

Figure 3 Dominant Social Fractionalization by Country



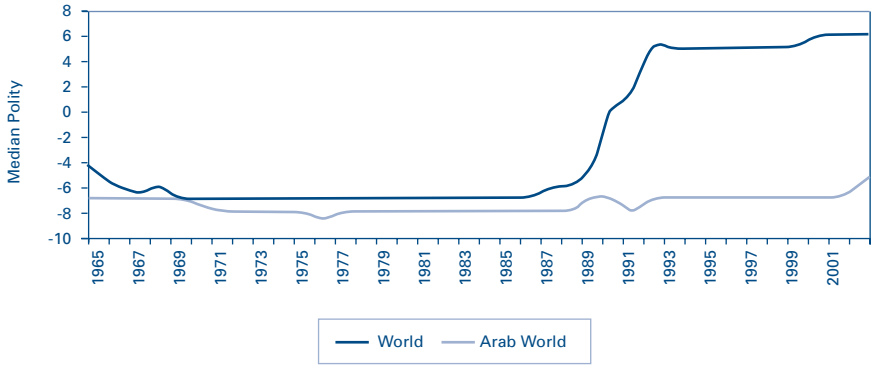
Source: figure is based on Table 5.

Figure 4 Dominant Social Polarization by Country



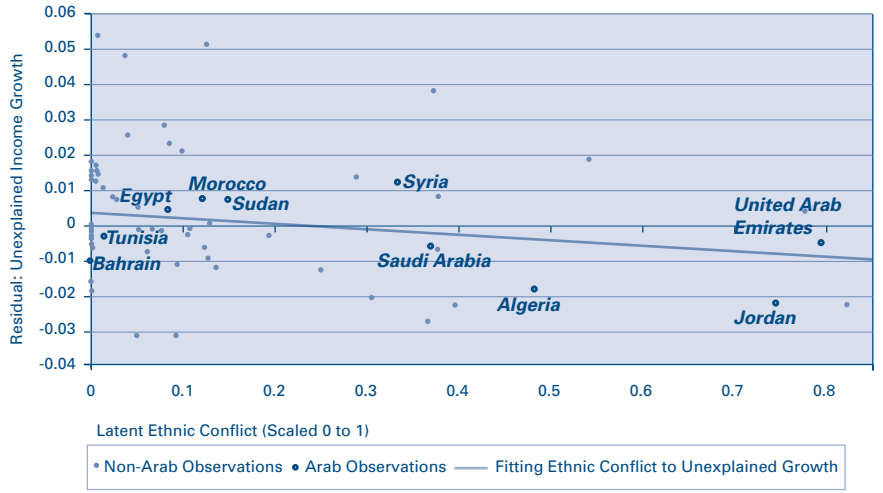
Source: figure is based on Table 6.

Figure 5 Median Polity 1965–2000



Source: Polity IV: Political Regime Characteristics and Transitions, 1800-2002. www.cidcm.umd.edu/inscr/polity/

Figure 6 Unexplained Change in Growth and Ethnic Conflict

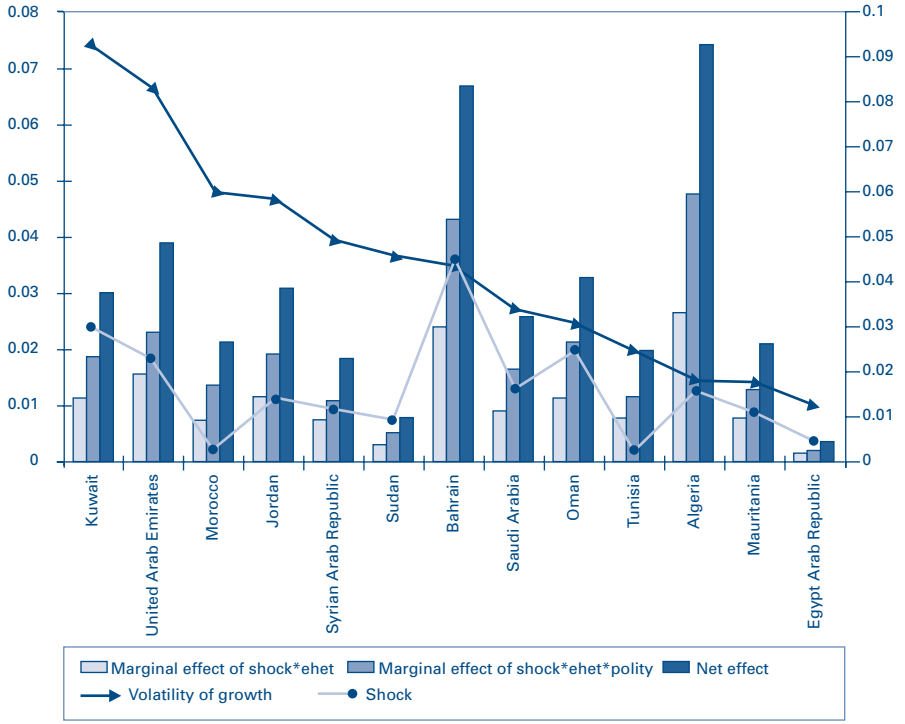


Source: World Development Indicators 2004; *UNCTAD Handbook of International Trade*, 2001; Alesina et al. (2003) data set.

Notes:

1. Residuals calculated from a parsimonious version of Regression 2 in Table 2, including only previous period growth, starting income and rule of law (and excluding ethnic fractionalization and ethnic conflict).
2. The fitted trend line is for Arab observations only.

Figure 7 Marginal Effects of Shocks on Short-Term Volatility



Source: World Development Indicators 2003. World Bank Data Base.

Notes:

1. Marginal effects are derived from regression 1 of Table 4.
2. The scale for the marginal effects ranges from 0.0 to 0.08 (left axis); while the one for volatility and Shock ranges from 0.0 to 0.1 (right axis).

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