

Democracy for Better Governance And Higher Economic Growth in the MENA Region?*

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1. Introduction

Democracy is valued in itself. The extent to which a citizen is able to live in an open society and participate in its democratic process affects directly his/her well-being. But democracy can also affect welfare indirectly through its effects on other aspects of the social and economic interactions that influence the well-being of people.

Democracy can often positively affect the relative rights of social groups, such as gender specific groups or minorities. In the economic area democracy may affect the distribution of income, with democracies, for instance, tending to pay higher wages and improve human capital. It may affect volatility of incomes with democracies

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tending to produce fewer recessions. Nobel Price laureate Amartya Sen observes that famines never occurred under democratic regimes. Democracy may also affect the rate of economic growth.

To the extent that democratic development reinforces and is reinforced by these various positive effects, democracy will generally gain more acceptance and opposition to it will weaken. But what happens if there are trade-offs between democratic development and any of these positive social and economic effects? What happens in cases when a democratic process brings into power a government which is able to pursue policies which undermine gender equality or the rights of some minority group? What happens in situations where democratic development leads for some reason to a *reduction* in incomes or a reduction in the rate of economic growth?

In these situations individuals and society may still value democracy despite the trade-offs. It is likely that most people today would go into such direction. Society may also introduce checks and balances and develop institutional mechanisms within the democratic process which would reduce or eliminate the likelihood a democratic process produces such negative outcomes.

In view of the complexity of the issues related to democratic development the objective of this paper is to discuss only a limited topic: does democracy tend to induce higher or lower economic growth? The aim is to help understand the links between democracy and economic growth. But it should be made clear that findings which show that democracy leads to less growth would not lead to any presumption that democracy should be sacrificed for the sake of growth. Such a choice needs to be made by any society (through a democratic process preferably!) given its special

circumstances. On the other hand a positive link reinforces the strength of arguments for democracy.

The paper will focus more specifically on the Middle East and North Africa Region (MENA)¹ given the recent emphasis on democratic development. Actually democracy has gone up dramatically on the agenda for and in the MENA region and countries. It has become an explicit objective of foreign policy for the United States as well as the G8. Whether it is *the* primary objective and whether it is being pursued effectively are issues which are subject to a much heated debate. But there is no doubt that promoting democracy has gone up high on the agenda of both the United States (US) and the European Union in the context of its European Neighbourhood Policy. Likewise, if not more importantly, is the increased domestic pressure for change from within the region. Civil society at large has been demanding more political openness over the last few years. This has been more eloquently and forcefully expressed in the United Nations Development Programme (UNDP) Arab Human Development Reports.

The reasons for the recent strive for democratic change are varied and complex. For the foreign players, they may have to do with the possible or presumed links between the lack of democracy and “terrorism”,² or between democracy and “security of borders”. For domestic actors they may simply have to do with the people of the region aspiring for more empowerment and freedom after many decades if not centuries of political oppression. But the paper is not going to delve into those issues.

The paper does not look into the determinants of democratic development either. For instance, there is a large literature and debate about whether economic growth fosters

democratization as first advanced by Lipset (1959). Most recently Friedman (2005) argues that over the long run a rising living standard fosters openness, tolerance and democracy. He recognizes, however, that in the short run economic growth makes more secure whatever political structure may be in place; while economic stagnation and crisis may undermine a non-democratic regime. Also in a recent review de Mesquita and Downs (2005) argue that while economic growth results in higher income and increases demand for democracy, it may also foster the ability of autocratic regimes to strengthen their power as they are able to shape institutions and political events to their advantage. Acemoglu et. al (2005) show that the strong cross-country correlation between income and democracy does not mean there is causality and that this correlation can be explained by historical factors which jointly determine both economic and political development paths of various societies. In a most ambitious analytical undertaking to date Acemoglu and Robinson (2006) develop a general framework using game theory for understanding how democratic development takes place and consolidates or not. This work shows that there are problems of simultaneity between democratic development and economic development which will be discussed when relevant. These issues go well beyond the scope of this paper.

In this paper we will consider the possible effects of a “given” democratic process without dwelling much about how it may have come about. Its scope is the relationship between “democratic development” and “economic growth”. From an economic perspective the objective is to determine whether there is a well defined relationship (or lack thereof) between the two, and more specifically whether one should expect democracy to “help” or “hinder” a stronger economic performance in general and in the context of the MENA region in particular.

In section 2 we provide the general context for the democracy-growth linkages discussion in the MENA region which is characterized by the existence of a democracy deficit as well as a growth deficit for the last two decades. With this background Section 3 reviews the empirical literature on the links between democracy and growth which focuses on direct links and uses mostly reduced form type models and concludes that the nature and strength of these links are at best ambiguous. More recent work on the relationship between democracy and growth surveyed in Section 4 pursues a more structural approach, looks at the intermediation channels and indirect links between democracy and growth as well as the role of the nature of the democratic regimes. One main conclusion is that the effect of democracy on growth, especially in MENA, depends to a large extent on whether a democratic transition leads to better governance and, therefore, better business climate and higher private physical capital accumulation. Then Section 5 explores the extent to which achieving better governance is more likely to be achieved under democratic regimes or non-democratic ones. Section 6 provides a brief discussion of a different approach to looking at the links between democracy and growth by postulating that while such a link may not be established systematically for any country at any time it may be important for most MENA countries today. In this case democratic reform may be needed to unlock the prevailing *status-quo* of low public accountability and the maintenance of prevailing economic policies and networks of privilege and generate a great political and economic transformation which could produce jointly more democracy and more economic growth in the region. The last section concludes that democratic development can be a strong lever for economic growth in the MENA region and that these countries should strive for democratic regimes which are sustainable in the sense of having characteristics which make them more likely to

produce good governance. Good “quality democracy” which produces quality governance, improves the investment climate and allows the emergence of a dynamic private sector can contribute to meeting the current development challenges of the MENA region which needs to achieve average growth rates of 6-7% per year in order to absorb the fast growing, increasingly educated and feminized labour force. The main focus should be on the design of the appropriate democratic institutions which (i) minimize imperfections in the political market, with more freedom of information and free press, adequate mechanisms to contain clientelism and increased credibility of political promises, (ii) introduce safeguards and effective checks and balances, (iii) increase the legitimacy of the democratic transformation, and (iv) in cases where there is significant ethnic and or religious fragmentation minimize the risks of social conflicts.

2. The Democracy and Growth Deficits in the MENA Region

At this point, it is perhaps useful to explain more the context of the discussion of the links between democracy and economic growth in the MENA region. This context can be summarized by the existence of both a “democracy deficit” and a “growth deficit”. Their simultaneous presence in practically all countries of the region (even though at different degrees) leads one to wonder whether any links exist between the two.

Before presenting the evidence about the democratic deficit it is useful to provide some basic references about the definition of democracy.³ At the most abstract level, democracy is a system of government (or of exercise of authority) in which effective political power is vested in the people and where major decisions of government and the direction of policy behind these decisions rests directly or indirectly on the freely

given consent of the majority of the adults governed. At the more practical level, democracy tends to be defined in procedural terms as the body of rules and procedures that regulate the transfer of political power and the free expression of disagreement at all levels of political life. More concretely it is defined as a political system where access to political power is regularly achieved through competitive, free and fair elections. As stated by Schumpeter (1942) it is “...the institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for the peoples’ vote.” (p.250).

2.1 Democracy deficit in the MENA region

Democracy has gained worldwide acceptance in recent decades. Without exception all developed countries maintain democratic systems, and many developing ones are selecting their leaders through competitive elections, i.e. moving toward more democratic political regimes. In a recent publication on lessons of the 1990s, World Bank (2005a) points out that “...a striking phenomenon of the 1990s was the rise in the number of countries selecting their leaders through competitive elections. The number rose from 60 countries in 1989 to 100 in 2000. Among poorer countries (those with less than the median country’s per capita income) the number nearly tripled, from 11 in 1989 to 32 in 2000; 15 percent of the poorer countries elected their governments in 1989 and 42 percent in 2000.” This shows a remarkable move toward democracy, but which did not spread to MENA as vigorously.

There is now a wide body of evidence about the “democracy gap or deficit” in the MENA region. It will suffice here to highlight some of this empirical evidence.

A first piece of evidence can be observed when using the well known composite Polity index from the Polity IV dataset.⁴ The composite Polity index (which ranges

from -10 for the least democratic regimes to +10 for the most democratic regimes) shows that the MENA region has consistently lagged behind the rest of the world suggesting that there is a persistent democracy deficit in the region (Figure 1). The MENA democracy deficit has existed over the last forty years, with the average regime in MENA remaining authoritarian according to this metric (negative values for the Polity index). While the Organisation for Economic Co-operation and Development (OECD) countries have been consistently democratic other regions in the world were traditionally not very democratic. The Polity index shows, however, a clear tendency towards democratization in developing countries outside MENA starting around 1977. Developing countries (other than MENA) have their average Polity index turning positive by 1991, with a gain of 7 points (30 percent of the scale) during the period 1977-2002.

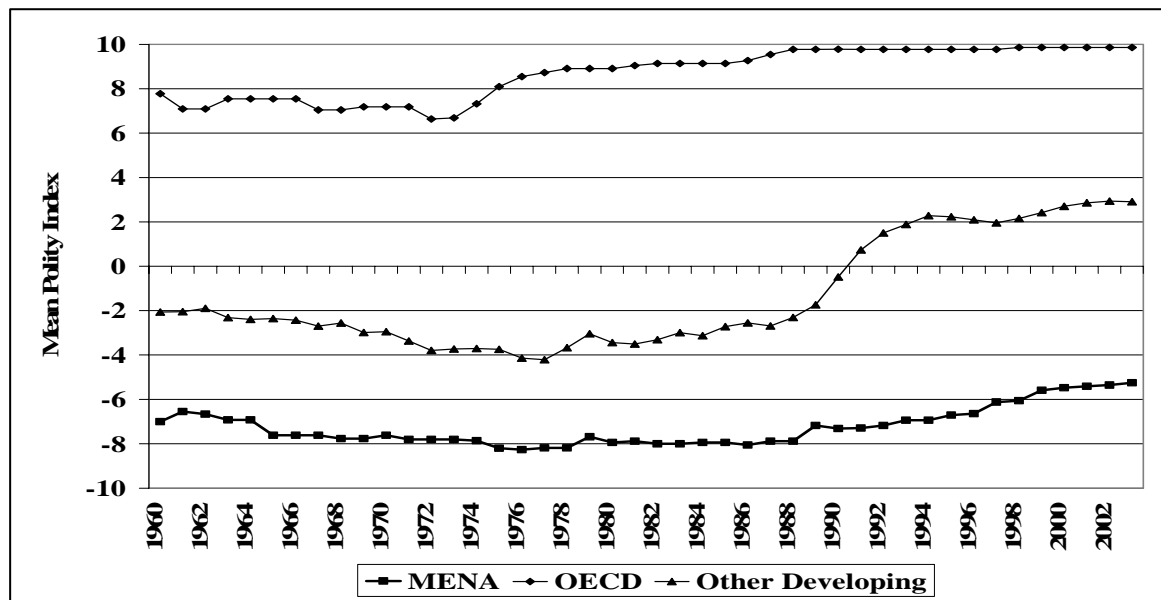


Figure 1. Democracy Trends in MENA and Other Regions
(Mean Polity Index 1960-2003)

During the 1960s on average the democracy level of countries in MENA and other developing regions was declining. The democracy gap between the two regions remained, however, relatively stable with a small declining trend during the period

covering the mid-1960s and the mid-1970s. The democracy gap reached its lowest point around 1977. Since then, the gap increased steadily, accelerating around 1990 as the Soviet Bloc disintegrated and new democracies emerged, particularly in Central and Eastern Europe. Since 1994 there has been a decline in the democracy gap between MENA and other developing regions, but the gap still remains significantly above the level attained in the 1970s. The democracy gap between MENA and the OECD increased steadily until 1988 when the average OECD Polity index reached its high plateau. At that point, the gap was almost 17.5 points or 88 percent of the scale. Since then the gap between MENA and the OECD has declined as gradual progress toward democratization has taken place in MENA. Nonetheless, the gap remains at 15 points or 75 percent of the scale, above the levels attained in the 1960s.

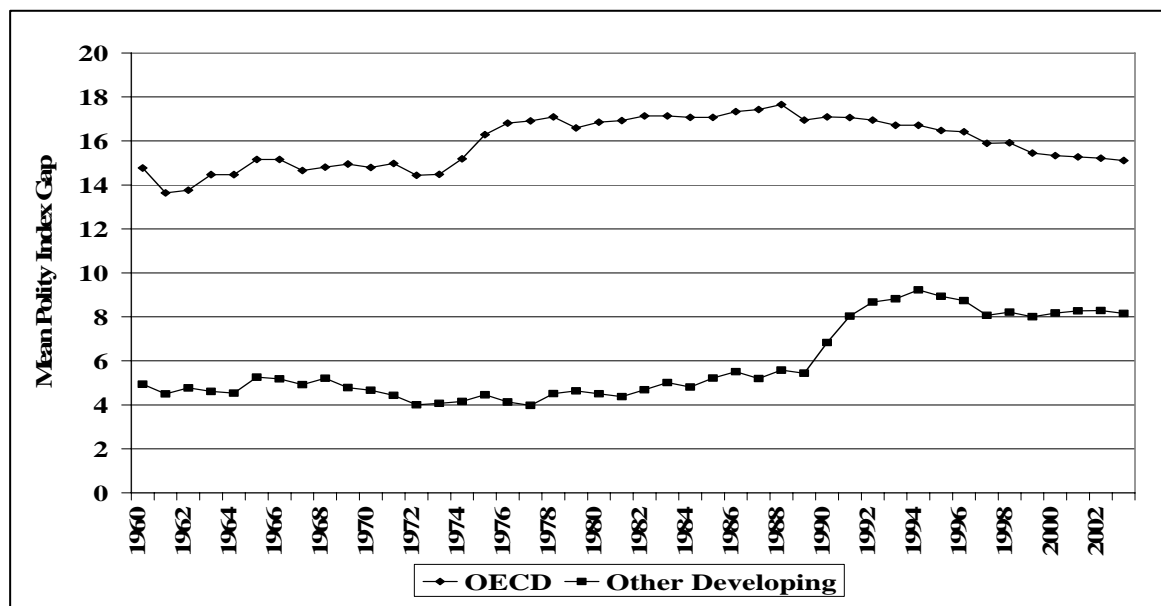


Figure 2. Democracy GAP between MENA and Other Regions
(Mean Polity Index 1960-2003)

A second piece of evidence comes from analyzing the trends in the Freedom House Political Rights index. This alternative measure of democracy has been used by several scholars (Acemoglu and Robinson 2006, Barro 1999).

The original Freedom House index ranges from 1 to 7, with 1 representing the most political freedom and 7 the least. We use the transformed Freedom House index (Acemoglu and Robinson 2006) which, following Barro (1999), is supplemented with data from Bollen (1990, 2001) for 1960 and 1965, normalized and transformed to lie between 0 and 1, with 0 corresponding to the least democratic set of institution and 1 to the most.⁵ This facilitates the comparison with the other indicators of democracy used in the paper.

Figure 3 plots the time series of the normalized Freedom House Political Rights index. The index confirms the low level of democracy in the MENA region, and a growing democracy gap with OECD and other developing regions in the world. As Figure 3 shows, the MENA region has a declining trend in the political rights index, losing ground particularly between 1960 and 1975, and between 1985 and 1990. The index reveals a small improvement in political rights in the period 1975-1980, at the hearth of the oil boom. The index also indicates little, if any, gains in political rights during the 1990-2001 period, contrary to the trends of the Polity index. This may indicate that while so elements of democratization were implemented, those related with political rights lagged.

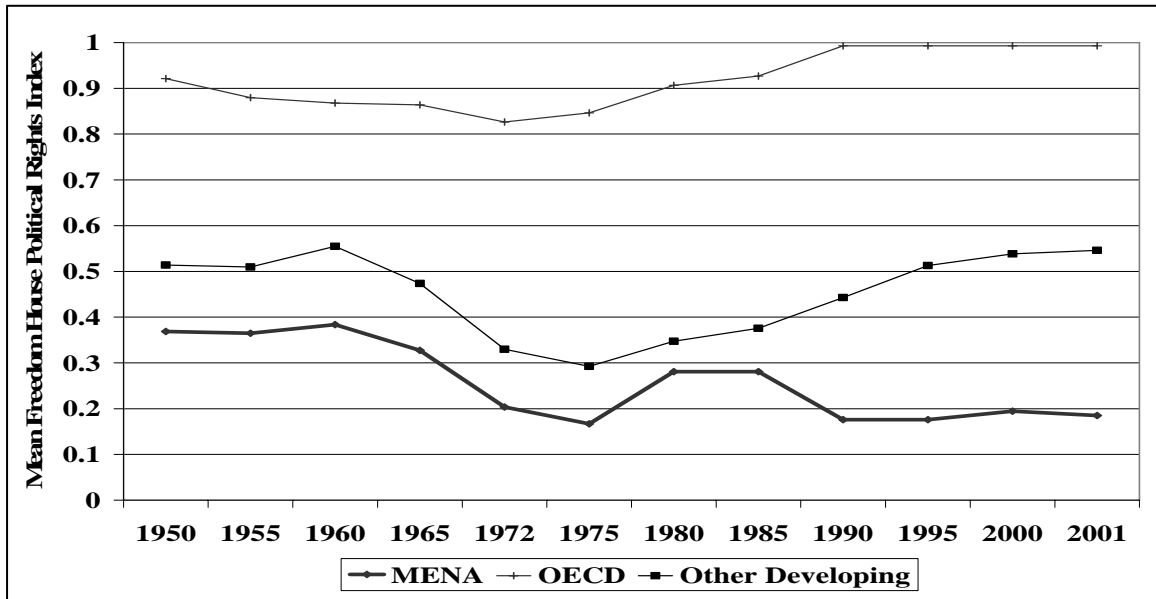


Figure 3. Freedom House Political Rights Index in MENA and Selected Regions
(Transformed Freedom House Index 1950-2001)

An analysis of the democracy gap using the Freedom House index shows increasing gap vis-à-vis OECD countries until the early 1990s. With respect to countries in other developing parts of the world, the democracy gap declined marginally during the 1960-1980 period. Since 1985, however, it has increased sharply as other regions of the world have moved much more rapidly towards increasing political rights and advancing democratic reforms.

A third piece of evidence on the gap can be found from the work of Papaioannou and Siouroumis (2004) who constructed a complete dataset on democratization in the world since the 1970s. The data used are wide ranging and go beyond the various quantitative indicators and use historical review of episodes. The authors find 38 episodes of “full democratization” and 24 episodes of “partial democratization” occurred in the world over the last 30-40 years. None of these episodes took place in the MENA region.

A fourth piece of evidence on the “democracy deficit” is the absence of the positive correlation between democracy and *level of income* in the MENA region, unlike what is typically found for the rest of the world. Przeworski et al. (2000) found that democracies are more frequent in developed (wealthier) countries while dictatorships are more frequent in poor countries. In typical charts showing the correlation between level of income and democratic development MENA countries tend to cluster way below the line. In particular the many oil producers tend to be less democratic than other less wealthy countries. The Gulf Cooperation Council (GCC) countries have among the lowest scores in the region using the Polity IV index.

Driving the gap between MENA countries and the rest of the world are the striking weaknesses in external accountabilities and in access to basic political and civic rights. World Bank (2003e) constructed an index of public accountability (IPA). The IPA assesses the process of selecting and replacing those in authority. It measures the quality of governance according to the inclusiveness of access to basic political and civic rights and the relative strength of external accountability mechanisms. It aggregates 12 indicators that measure the level of openness of political institutions in a country and the extent to which political participation is free, fair, and competitive; civil liberties are assumed and respected; and the press and voice are free from control, violation, harassment, and censorship. It also captures the transparency and responsiveness of the government to its people and the degree of political accountability in the public sphere.

All countries in the MENA region, whatever their income, score well below the world trend in the IPA (Figure 4). Some richer MENA countries score especially low on the

IPA—with scores equivalent to those in some of the poorest countries of the world.

Oil seems to matter as oil-exporting countries have the worst IPA scores.

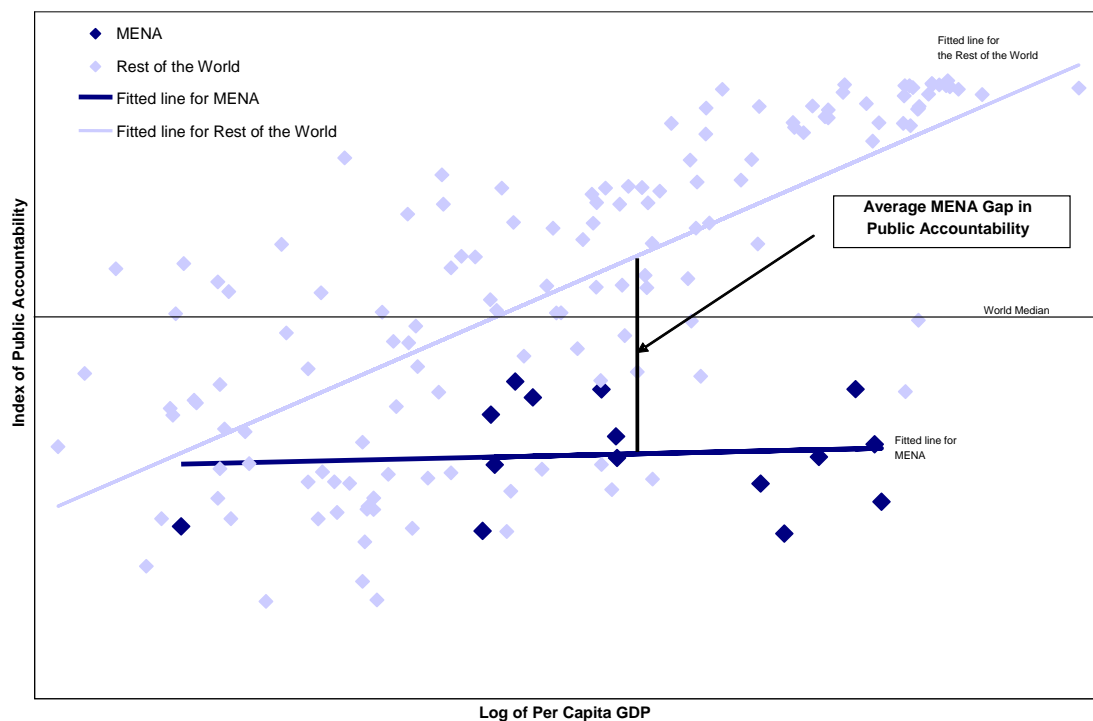


Figure 4. Public Accountability and Per-capita Incomes in MENA

2.2 Economic growth deficit in the MENA world

The recent history of economic growth in the MENA region can be easily. MENA's historical model of economic development was based on state-led development and central-planning, economic and social policies designed for redistribution and equity, and a strong social contract between governments and the people they represented.

During 1965–85 economic growth per capita averaged 2.9 percent per year, second only to the East Asia and Pacific region (Figure 5). Many factors contributed to these performance, including rapid progress in early-stage industrialization; high levels of public employment and spending, especially on infrastructure; trade protection for

domestic producers; and rising oil prices that yielded large capital inflows, created jobs, and promoted remittance flows into non-oil-producing MENA states.

While this development model paid large dividends in the beginning, particularly on social indicators, there were also significant costs. Centralized and hierarchical governments emerged in MENA, with limited transparency and contestability of representatives or policies. The MENA development model also created economies that had great difficulty adapting to shocks and economic change.

As early as the late 1970s the economic systems that had developed in MENA—and that carried the people in the region through an unprecedented era of achievements—showed signs of cracking under stress. The high growth rates were becoming increasingly costly to achieve. Though investments were at record levels, with the rate of growth of physical capital per worker increasing by more than 80 percent in the 1970s over the 1960s, these investments were inefficient, having increasingly smaller growth payoffs. As a result of large inefficiencies total factor productivity growth was lower than in any other region of the world and turned negative during the 1970s.

The MENA region entered the 1980s with mounting evidence of strains and difficulties to sustain the promise of continued prosperity. Facing declining public revenues after the oil shock in the mid-1980s, governments struggled to maintain their growth performance and redistributive commitments. With a public sector wage bill accounting for as much as 20 percent of gross Domestic Product (GDP), deficits mounted and debt grew at an alarming rate. The fiscal strains contributed to large macroeconomic imbalances. Productivity growth, already declining by the 1970s,

plummeted to –1.5 percent a year on average over the 1980s. Real output growth collapsed under the multiple blows of declining public spending, in part a result of the negative oil shocks, an unattractive private investment climate, and continuing losses in efficiency. GDP per capita stagnated over the 1980s, growing an almost imperceptible 0.3 percent a year during the decade.

In the 1990s several macroeconomic stabilization reforms were implemented and they began to pay off important dividends. By and large, MENA countries recovered from the instability of the 1980s. Inflation was brought under control, debt levels declined, and macroeconomic performance turned positive on average. These were fundamental pre-conditions for higher private investment and growth, but the strong growth rates needed to cope with the demographic transition of the region failed to materialize. Despite the mentioned reforms the effort did not translate into the strong economic recovery that was anticipated. Though GDP growth improved over the crisis-ridden 1980s, per capita growth remained weak, averaging 1.5 percent a year in the 1990s. While the declines in productivity growth were arrested, productivity growth was close to 2 percentage points lower than the world average and 3.5 percentage points lower than East Asia at about the same levels of investment.

With the coming of the new millennium, the region has experienced a new set of favourable conditions. As a result, the region has achieved exceptional growth over the last few years. Accelerating in the early 2000s, economic growth in the MENA region (excluding Iraq) averaged 5.1 percent a year over 2002-2004, the strongest growth rate in a decade, and significantly higher than the average yearly growth over the 1990s. On a per capita basis, the MENA region's 3.2 percent average growth over 2002-2004 was its strongest growth performance since the mid-1970s.

Despite the oil-driven growth boom, on a per capita basis, the region's growth rate over the last few years continues to lag that of most other regions, a reflection of both the firming of GDP growth rates across developing regions and the MENA region's still high population growth rate that continues to be a key development challenge. At the regional level, per capita growth in East Asia and the Pacific, South Asia, and Europe and Central Asia all outpaced MENA's per capita GDP performance in both 2003 and 2004.

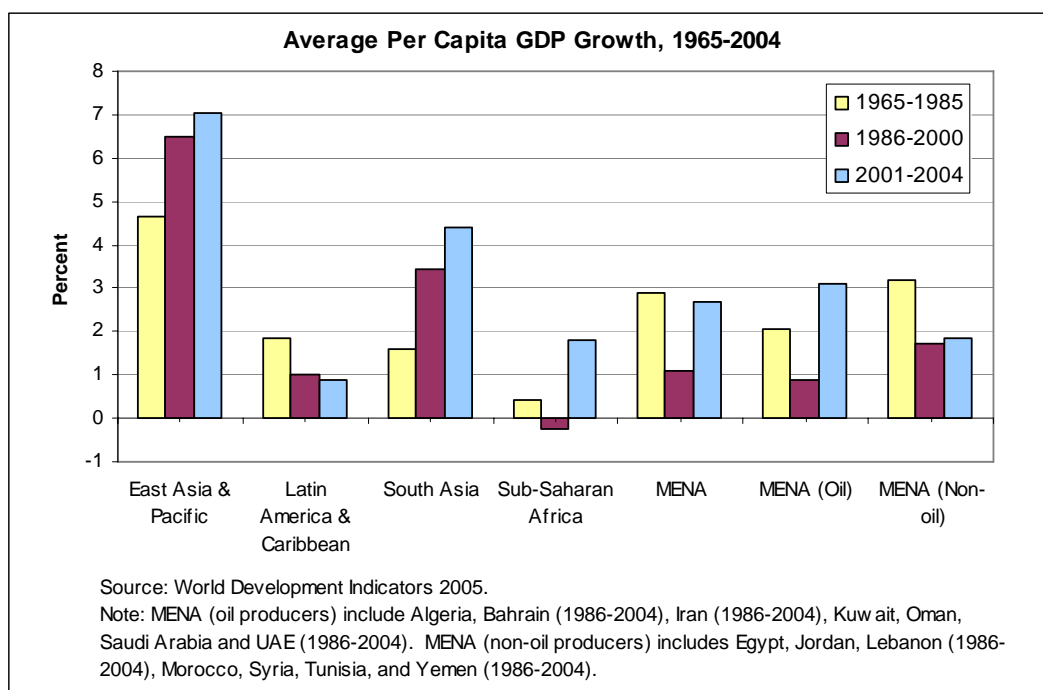


Figure 5. Average Per Capita GDP Growth, 1965-2004

In sum, over the past two decades the MENA region has experienced a growth deficit with low per-capita income growth. This growth performance has been weaker than the one achieved by most other regions of the world, except for Sub-Saharan Africa.

3. Empirical Correlation and Direct Links between Democracy and Economic Growth

The previous discussion leads one to be tempted to hypothesize that there is a strong link between the low growth and the democracy deficit in the MENA region. This section reviews more thoroughly the international experience on the empirical relationship between democracy and growth and investigates how it applies for the MENA region.

From international experience, the economic success of many authoritarian regimes like Singapore, South Korea, and Indonesia during the 1970s and 1980s, Chile in the 1980s, and China over the last 20 years has always cast some doubt on the existence of any robust (positive) linear relationship between economic growth and democracy. Empirical studies using standard growth regressions models and cross-country data have found mixed evidence for such direct links. Reviews of a large number of these studies (see Borner et al. 1995) found that only very few show any strong positive relationship, with most showing either insignificant results or even a negative link. Using the Freedom House indicator for democracy (electoral rights) Barro and Sala-i-Martin (2003) show that a non-linear relationship may exist, similar to a Laffer Curve, in which democratization appears to enhance growth for countries that are not very democratic but to retard growth for countries that have already achieved a high degree of democracy. Przeworski et. al. (2000) analyzed the data over a long period of time and concluded that when countries are observed across the entire spectrum of conditions total income grew at about the same rate for democratic and undemocratic regimes. However, they found that patterns of growth varied between democracies and non-democracies, particularly in wealthy countries.

The history of the MENA region over the last 50 years shows limited experience with democracy and political openness. But while no country in the region has achieved a full transition to democracy, the degree of political openness and use of the election process to choose the government in power has varied significantly over time and across countries. The high income growth rates achieved in the 1970s and early 1980s were not accompanied by any significant degree of political openness, while the growth collapse of the 1980s saw some degree of political liberalization in several MENA countries. During the 1990s the experiences of low economic growth countries, like Morocco was associated with gains in democratization while higher growth countries like Tunisia were increasingly autocratic. At the same time Jordan experienced higher growth and political openness while low growth and limited democratization was the norm in most Gulf countries. Overall, there is little correlation between changes in democracy and changes in income per capita during 1970-2003 in MENA and the rest of the world (Figure 6). Countries that grow faster than others have not become more democratic.

The lack of strong empirical evidence of *direct positive links* between democracy and economic growth, which seems to apply for the MENA region as well, has led research to move into new directions for the study of the linkages between democratic and economic development. We look at some of them in the next section.

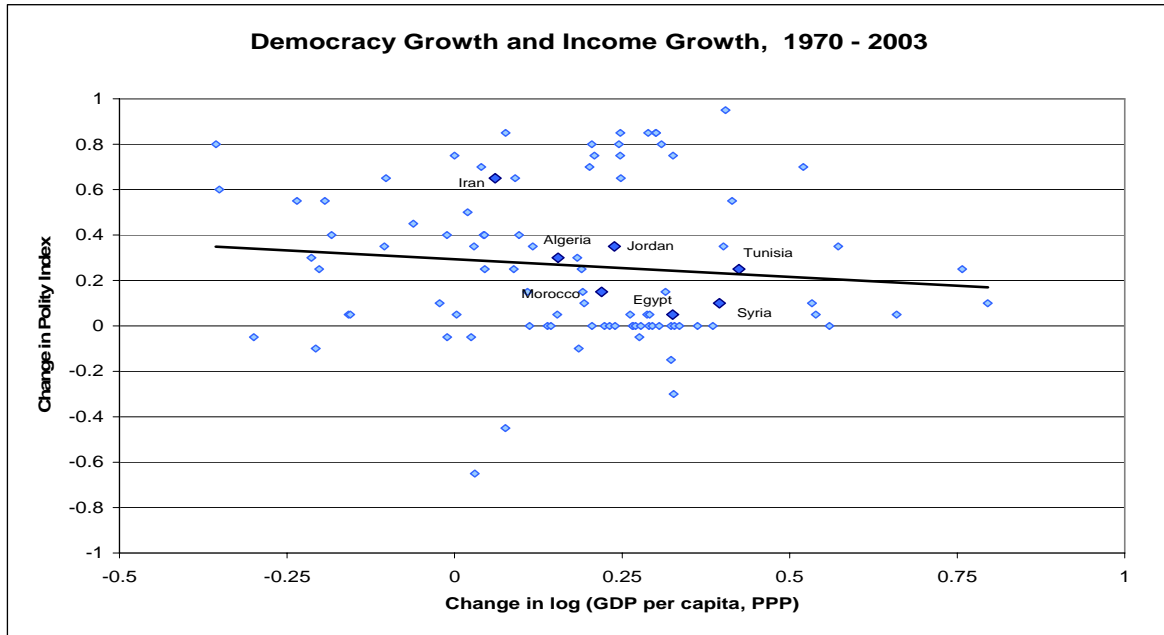


Figure 6. Democracy Growth and Income Growth, 1970-2003

4. Structural Analysis of the Links between Democracy and Economic Growth

4.1 Indirect links from democracy to economic growth

Recent research has gone into three directions of study for the (*indirect*) linkages between democratization and economic growth.⁶

The *first direction* explores more carefully the theoretical and empirical links between democracy and economic growth going beyond simple correlations and cross-country regressions which considered the direct links. These studies look at the indirect effects of democracy on economic growth through a number of intermediation channels. They use structural models which involve income growth, democracy and variables which represent such intermediation or transmission channels. Some of these channels show a negative impact of democracy and economic growth, while others show a positive link. A focus on the inefficiencies of representative government, using the “median voter model” or the public choice approach, would

imply that democratic regimes result in larger demand for redistribution and prevalence of special interest politics. This may result in higher government consumption, higher taxation, more redistribution, and lower private investment. All these channels would imply lower growth rates.

But many other channels would lead one to expect a positive impact from democracy to economic growth. First, redistribution and higher taxation may result in higher human capital accumulation through larger subsidies and dealing with capital market failures. Second, democracy deals better with economic instability through better commitment achieved through the political process. Political instability is part of everyday life in democracies and does not affect economic growth as much as in the case of authoritarian regimes. In non-democracies any changes or expectations of leadership changes affect negatively investment and growth: whenever dictators are expected to be removed growth declines sharply (Przeworski et al. 2000). Such non-democratic regimes are successful only if they are stable. Shocks therefore have large negative impacts on economic growth. In addition, democratic regimes are better suited at both the mediation of conflicts among interest groups and responding to exogenous negative shocks (Rodrik 1997, 1999). Countries with higher degrees of social and ethnic fragmentation and weak democratic institutions are found to have suffered the sharpest drops in GDP after shocks.

Tavares and Wacziarg used a full system of simultaneous equations and panel data for the period 1970-89. They found that democracy fosters growth because it improves human capital accumulation and, in a weaker way, because it reduces income inequality. At the same time they find that democracy hinders growth by reducing physical capital accumulation and in a less robust way by increasing the government

consumption to GDP ratio. However, no significant impact is found through the channels of political instability and policy distortions. The overall effect of democracy on growth is slightly *negative* mainly through the large impact on the reduction in the rate of physical capital accumulation. In a similar vein Feng (2003) conducts a wide ranging empirical study of the impact of political institutions on economic growth. He finds that democracy has an insignificant direct effect on economic growth, but indirect effects are strong and significant. These indirect channels include political instability, policy uncertainty, investment, education, property rights and birth rates.

The *second direction* goes beyond cross-country analysis and uses intensively event analysis and differences in performance for *before and after* democratization episodes. Empirical findings from this analysis tend to show a positive impact of democratization in a given country's economic growth. From a theoretical standpoint the evidence presented in this new branch of the democracy-growth nexus literature offers direct support for so called development theories of democracy and growth that highlight the growth enhancement aspects of the democratic process. From a policy perspective the results suggest that democratic institutions, *if properly introduced and adapted*, can bring substantial growth benefits. They also suggest an important role for the international community, to help mitigate the transition costs, which can be high and impede the consolidation of democratic rule.

To assess whether a successful democratic transition is associated with faster growth, Papaioannou and Siourounis (2004) first identify countries and their exact timing of *permanent democratizations* in the period 1960-2000. They employ an event study approach and analyze the evolution of GDP growth before and after such incidents of

political modernization. Using a dynamic panel with annual observations, and econometric techniques that address concerns on shortcomings of previous research, the study reveals that conditioning on various growth determinants, global shocks and business cycle effects, a permanent democratization is associated with approximately one percent increment in real per capita growth. The analysis also reveals a *J-shaped growth* pattern. This implies that output growth drops during the democratic transition, but then fluctuates at a higher rate suggesting a “short-run pain”, due perhaps to high transition costs and learning, followed by “long-run gain” due to higher growth after the consolidation of democracy. The effect is robust to various model specifications, panel data methodologies, alternative democratization dates, and to the potential endogeneity of democratization. Their methodology enables them to quantify both the short and the long-run correlations of political modernization and growth. Their results favours the Aristotelian notion, recently put in another way by Friedrich Hayek that the merits of democracy will come in the long run.⁷ That is, stable democracies can foster growth.

Papaioannou and Siourounis work is related to a new wave of research that studies the effect of institutions on economic performance.⁸ Their results suggest that besides legal norms or property rights protection, the type and quality of political institutions correlates substantially with economic growth. The overall effect of democracy on growth is then *positive* in these studies.

The *third direction* of the literature goes beyond the general dualistic specification of political regimes into democratic and non-democratic and explores a number of dimensions. A significant amount of work, mostly on advanced countries, looks at how the nature and rules of the democratic regimes affect outcomes. Whether these

regimes are presidential or parliamentary or whether they use majoritarian or proportional representation does matter for the way democracy affects economic outcomes.

In recent parallel studies Persson (2004) shows that income gains following a democratization are high, when the transition leads to a proportional representation (versus a majoritarian) or when it leads to a parliamentary (versus presidential) system. Giavazzi and Tabellini (2004) document significant interactions between economic and political liberalization and show that countries experience substantial growth gains when they first liberalize the economy and then the polity.

For developing countries the focus has been on how imperfections in electoral markets tend to make democracy less effective in achieving good government compared to advanced countries (World Bank 2005a). Imperfections in electoral markets—lack of voter information, the inability of political competitors to make credible promises, and social polarization—are important to understand policy formulation and explain differences in economic performance between rich and poor democracies. Voters in developing countries tend to be less informed, the role of media weaker and campaign financing more prone to capture which result in worse governance outcomes. At the same time, politicians tend to be less credible, and clientelism more pervasive, especially as the length of exposure to elections tends to be shorter. In addition, social polarization and ethnic fragmentation distort the electoral processes.

The empirical findings from this strand of the literature tend to *condition* the possible impact of democratization on growth on how severe are the political market

imperfections. Differences in economic performance across democracies can be explained by imperfections in electoral markets. Numerous imperfections in electoral markets make it difficult for citizens to hold politicians accountable for policies. Elected governments are most likely to make policies favouring narrow segments of the population at the expense of the majority when citizens do not have good information mechanisms, cannot trust promises made prior to elections, or are in societies that are deeply polarized. These factors are three of the most important political market imperfections that affect policy outcomes. In contrast, elected governments are most credible and most likely to respect private property rights when they confront checks and balances on their decision making. Thus, accountability becomes an essential component.

Informed voters are necessary for good political outcomes. Without information about what politicians are doing, and how their policies affect citizens' welfare, or about the attributes of political competitors, citizens cannot easily identify and reward high-performing politicians. As a result, bad performance is encouraged and bad political outcomes are likely to occur. In political markets, information about the characteristics of political competitors and government performance is key. Proxies like newspaper circulation are commonly used in empirical analysis for voter information, and reveal, controlling for income and other factors, that higher newspaper circulation is associated with lower corruption, greater rule of law, better bureaucratic quality, and greater secondary school enrolment (Keefer and Khemani 2005).

Credible commitments by politicians are also important for good governance outcomes. When challengers cannot make credible policy commitments, citizens have

no reason to prefer them over incumbents. Even if incumbents do badly, citizens have no reason to believe that challengers will do better. This insulates incumbents from competition and diminishes pressure to perform. Politicians may only be able to make credible promises to some voters, generating clientelism and incentives to politicians to under provide public goods and extract large rents.

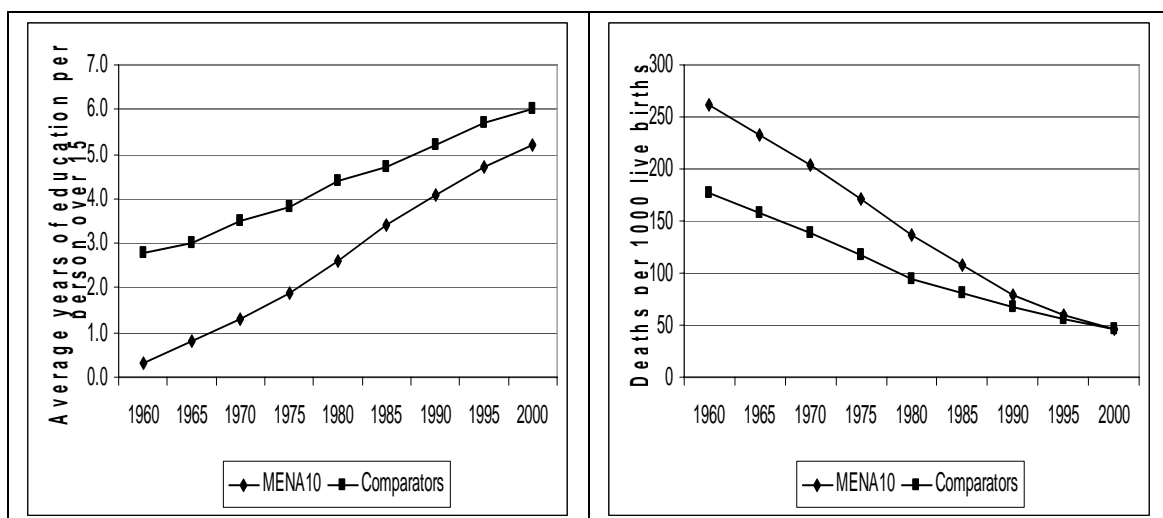
Likewise, social polarization hinders the capacity for political systems to generate good outcomes. Social polarization undermines the accountability of government to citizens. In extreme cases, deep divisions among social groups hinder the capacity of one group to elect a representative of the other, irrespective of his/her characteristics, political platform and qualities as a representative. Elected representatives from one group then have no incentive to address the concerns and solve the problems of citizens in the other, generating distortions in the provision of public goods. Empirical studies show that measures of ethnic tension are higher in poorer democracies than in rich ones. The consequences of social polarization can be worsened by all the factors that undermine voters' ability to hold politicians accountable.

4.2 Implications for MENA countries?

What can be concluded from the previous brief survey for MENA countries? Does it mean that democratic reform is unimportant for economic growth? Since the survey shows a lot of uncertainty about the causal links from democracy to economic growth, MENA countries should not expect that the pursuit of democratization would in itself bring quick benefits in terms of economic growth. One can be tempted to conclude that the search for higher economic growth should focus more on traditional policy and institutional reforms within any existing political regime. In that case the strive

for democratic development would be a different track which should remain separate from that of economic growth.

But such a conclusion is premature. In fact the previous discussion suggests that there are some robust positive effects of democracy on growth through higher human capital accumulation. But is such a link likely to be relevant and significant in MENA countries? There is a lot of empirical evidence that MENA countries have achieved strong gains in terms of human development during the last 4-5 decades in the presence of non-democratic regimes (World Bank 2006). Some of the most impressive improvements in human development indicators took place in the MENA region between 1960 and 2000, surpassing the performance of countries in other regions with similar Purchasing Power Parity (PPP) income levels. For instance, average years of education in MENA increased by over 500 percent and in the case of women by over 800 percent during the 1960-2000 period. Child mortality decreased from an average of 262 deaths per 1000 births to an average of 47 deaths per 1000 births during the same period. Life expectancy at birth improved from 47 to 68 years, a 45 percent increase.



Source: World Bank (2006). MENA10 refers to Algeria, Egypt, Iran, Jordan, Lebanon, Libya, Morocco, Syria, Tunisia and Yemen. Comparators include 32 countries with similar income levels of MENA countries in PPP terms in 1980

Figure 7. Human Development Indicators in MENA improved considerably

Actually one can argue that regimes in MENA did strive to buy the loyalty of citizens through strong redistributive programs such as free access to education and health, public sector jobs and lower prices for basic commodities. It is unlikely that this channel of increased investment in education would be important for increasing growth in MENA countries over the coming period. On the other hand there is a general recognition for the need for education reform to improve quality and adequacy of education to changing economic conditions, and governance mechanisms may turn out to be critical for success of these reforms.

The previous analysis shows also that there are some robust positive effects of democracy on growth through better commitments to policies with a more credible and predictable political process and through better intermediation of conflicts. Such effects are likely to be relevant in many MENA countries and situations.

Another conclusion from this review is that for a number of other links from democracy to economic growth the effects are largely contingent on whether a move towards more democratic government would lead to better governance. In particular there is uncertainty about the impact of democracy on capital accumulation and policy distortions. This uncertainty is most likely related to the extent to which democracy leads to more or less respect for property rights, policies which favour broader or narrow interests, and adequate or under-provision public goods; which in turn depends on the strength of politicians' credibility and pervasiveness of clientelism.

The main general conclusion is that the net impact of democracy on growth depends on the severity of political market imperfections or in other words whether democracy produces good governance and thereby enhances physical capital accumulation. This

conclusion is strengthened by two additional and complementary findings from the literature on governance (without reference to democracy) which show direct strong positive links between good governance and economic growth and between better governance and higher private investment. The latter linkage is particularly important for the MENA region.

4.3 Governance and growth

The work of Buchanan, et al (1980), Evans (1989, 1995), North (1981, 1990), and de Soto (1989) systematically linked country characteristics such as the security of property rights directly to the wealth of nations, improving the understanding of the effects of the non-policy characteristics of government performance on economic development and growth. The research stemming from this strand of the literature brought to the forefront the contribution of previously under-examined issues like the security of property rights, the rule of law, expropriation, bureaucratic quality, red tape, and the quality of regulation.

Both empirical evidence and theory support the influence of *individual* components of governance rather than *aggregated* concepts of governance on development and growth. Studies have found that some governance components have stronger links than others (Keffer 2004b). The security of property rights, the credibility of governments (see Knack and Keefer 1995, Acemoglu and Johnson 2005, Acemoglu, et al. 2001, Rodrik, et al. 2002, Hall and Jones 1999) and an honest and efficient bureaucracy emerge as the components with the best documented and strongest links with economic development and growth. On the other side, causality problems cloud estimates of the influence of bureaucratic capacity and corruption on development. In addition, analyses of voice and accountability, while the subject of substantial

attention among researchers, have suffered from a lack of theoretical and empirical precision that clouds interpretation.

The theoretical case for secure property rights is based on basic idea that economic agents do not invest when the business environment is not right and they fear potential confiscation of their assets by government. Still, there are objections to the theoretical case linking the security of property rights to growth.⁹ One relates to the fact that often two important notions of property rights are confused, the *allocation* of property rights and the *security* of property rights. Democracy may render property rights less secure because the introduction of democracy creates opportunities for the poor to redistribute incomes away from the rich. However, it is not democracy, *per se*, that creates insecurity, but the transition to democracy. Once democracy is established, there is no reason to expect the distribution of property rights to change further.

Some contributions to the governance literature refer not only to the security of property rights but to the closely related but somewhat broader concept of “government credibility.” This is the case with Knack and Keefer (1995), for example. Only credible governments can assure investors that their assets are safe from expropriation.

In the contest of MENA, some empirical evidence shows that better governance may have a significant positive effect on economic growth. Weaker governance in MENA costs 1.0 to 1.5 percentage points in forgone annual GDP growth (World Bank 2003e). On average, improving the quality of institutions by one standard deviation—approximately equivalent to raising the average institutional quality in MENA to the

average institutional quality of comparable East Asian countries (Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam)—would have resulted in an increase of almost 1 percentage point in average annual GDP growth for the region as a whole. This figure would imply an income level that is 50 percent higher in a period of 40 years due to compounding. The gain in growth rate from better governance will rise to a 1.5 percentage point difference for the group of MENA countries with substantial oil and gas revenues, implying an income level 81 percent higher in the same comparative period. Similar results have been found by Elbadawi (2002).

4.4 Governance and private investment

The influence of the quality of governance on growth works primarily through its effect on private businesses and their capacity to invest. Numerous studies (see World Bank 2003e) have documented the relationship between governance and private sector activity. Businesses react to the incentives, costs, and constraints that form their business environment. Those reactions are, in turn, influenced by the shaping and implementing of public policies.

Improved governance can produce better business climate that foster investment, productivity and growth. It reduces the scope for arbitrary government policymaking, providing mechanisms that help countries minimize the persistence of policy distortions. By ensuring public accountability of politicians and bureaucrats, better governance also contributes to the effective implementation of economic policies that are conducive to growth.

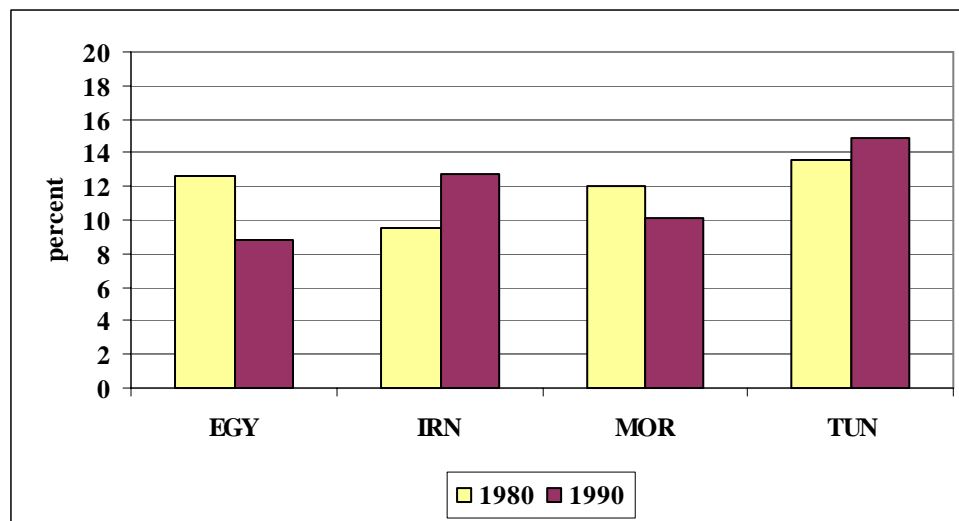
Better governance also improves bureaucratic performance and predictability, reducing uncertainty and the costs of doing business. This enhances the business environment. Better governance makes it easier to start new businesses and to run and

expand existing ones. It lowers transaction costs at all levels (entry, operation, and exit), reduces information asymmetries between business and governments, and lowers uncertainties and unpredictability. It does so by protecting and enforcing property rights, curbing burdensome administrative and judicial rulings, reducing red tape, ensuring good regulatory quality, and improving access to affordable and reliable recourse to dispute resolution. By helping ensure more orderly public accountability processes, better governance also reduces political risk.

Better governance contributes to the effective delivery of public goods that are necessary for productive businesses. Firms operate in a commercial environment that depends on many key public goods. And better governance helps ensure that such goods are available in a timely, equitable, and cost-efficient manner. Public goods that are essential for a good business environment include appropriately regulated public utilities and natural monopolies, a stable and prudently regulated financial system, public safety and low crime, and good quality health and education. Effective delivery of these and other public goods boosts the productivity of private investment and leads to faster growth and development.

A recent empirical study (Aysan, Nabli and Végonzonès –Varoudakis 2006) provides a quantification of the possible impact of better governance on private investment for a few MENA countries (Egypt, Iran, Morocco, Tunisia). They use panel data and a simultaneous equation model for private investment and governance indicators to estimate this impact. They find that improved governance indicators, in terms of quality of public administration and public accountability, equivalent to one standard deviation of observed variability would yield about 3.5 percentage points on increase in private investment to GDP ratios. For MENA countries this would have increased

the ratio of private investment to GDP on average from 12 percent to 15.5 percent which is a significant impact.



Source: Aysan, Nabli and Véganzonès-Varoudakis (2006).

Figure 8. Private Investment in the MENA Region Remains Low

5. Better governance is critical but how?

Governance is among the more elastic concepts in the social science and development lexicons (Keefer 2004a). Definitions tend to include the extent to which governments are responsive to citizens and provide them with certain core services, such as secure property rights and rule of law, and the extent to which public sector institutions and processes give government decision makers an incentive to be responsive to citizens.

Good governance requires inclusiveness, transparency and accountability in the management of public affairs. The governance challenge in the MENA region is to strengthen the incentives, mechanisms, and capacities for more accountable and inclusive public institutions and to expand allegiance to equality and participation throughout society. Those good governance mechanisms are first steps in improving economic policies that are themselves instruments for better economic growth.

The previous discussion makes a strong argument that democracy can have a positive impact on economic growth if it leads to better governance. But is democracy likely to generate good governance and are there alternatives to achieving good governance?

5.1 From democracy to better governance?

Researchers have developed various arguments that link democracy to both greater and worse quality of governance. The introduction of democratic institutions in the form of more political and civil rights, and freedom of the press, among others, may or may not be associated with improved governance. On the one side, democracies allow populations to peacefully and regularly oust inept, inefficient and corrupt public administrations and to keep more efficient, successful regimes, thus tending to make the quality of governance on average higher in the long-run. On the other side, a number of studies have noted that the proliferation of interest groups lobbying for power or for rents under democratic institutions may lead to policy gridlock, pervasiveness of clientelism and lack of accountability. This could hinder growth prospects.

The empirical literature appears to confirm that stronger democratic institutions are positively associated with a higher quality of governance, as well as with its positive impact on growth (Rivera-Batiz 2002, Keefer 2004a). Stronger democratic institutions influence governance by constraining the actions of corrupt and inept officials. They also facilitate the activities of the press, which can monitor corruption and disseminate information on government officials to the public so that they can be held accountable.

But research and experience have shown many situations where democracy is unlikely to produce better governance. For instance, it has been often observed that younger democracies are more corrupt, exhibit less rule of law, and lower levels of bureaucratic quality. These young democracies spend more on public investment and government workers. The politicians are less credible (Keefer 2005), and the inability of political competitors to make credible promises to citizens leads them to under-provide public goods, over-provide transfers to narrow groups of voters, and engage in excessive rent-seeking. Young democracies seem to require time to mature to generate the desirable results.

Democracy may also not lead to better governance and higher growth in MENA due to social cleavages and fragmentation as discussed above in the context of the importance of political market imperfections. The literature on these issues has shown that getting democracy right is also affected by the extent of social cleavages. Elbadawi (2004) tests for the impact of social cleavages on growth. In his model, social cleavages are measured by indexes of (ethnic, cultural or religious) fractionalization and polarization. He finds that several MENA countries have highly ethnically and/or religiously fractionalized societies including Djibouti, Jordan, Lebanon., Iraq, and Syria. Like other authors before (Alesina et al 2003, Easterly and Levin 1997 and Rodrick 1998) Elbadawi finds that the conflict variable that measures the social cleavages in his model has a negative effect on growth. The conflict variable was highly significant for the case of ethnic fractionalization and moderately significant for the cases of language, religious and dominant polarizations. In all cases, it was negatively associated with long-term stability of growth. The results are much less robust for the case of the polarization-based conflict. However, ethnic and,

especially, language polarization were negatively and significantly associated with long-term growth stability.

This analysis indicates that relatively socially homogenous societies in MENA (Egypt and Tunisia) may be better suited to get good governance through democracy while less homogenous societies in MENA (Iraq, Lebanon, Syria) may find it more difficult to achieve the needed socio-political consensus for good governance and good economic policy.

5.2 Should the strive be just for “better governance”?

If there are risks that democracy does not lead to better governance , i.e. more transparency, better voice and accountability, more secure property rights, less corruption, more efficient civil service and more effective public service delivery; what are the implications for the MENA region?

One possible implication may be that MENA countries should strive to achieve “better governance” and not to bother with seeking democracy. Countries should try to develop features of good governance such as secure property rights, rule of law, efficient and less corrupt government and public administration, predictable rules and laws and so on. The economic success of authoritarian regimes particularly in Asia, like China, Taiwan, Singapore and South Korea, and even in some MENA countries such as Tunisia and Egypt who achieved relatively high rates of growth over the long run suggests that this is possible and that some adequate quality of governance can be secured under such regimes. Some even raise the question whether the very authoritarian discretion of such regimes actually helped growth by enabling the leading parties to push through economic reforms that in a democratic setting might

have been either slower due to a need for consensus or impossible to achieve. This argument would be even more compelling in situations where there is a high likelihood that democracy would not generate better governance because of significant social cleavages.

Many argue that this is not the case and that democracy need not to be sacrificed on the altar of development. While East Asian countries have prospered under authoritarianism, many more countries have seen their economies deteriorate due to the lack of democracy and accountability, for example Zaire, Uganda, or Haiti. Such cases abound in MENA with the examples of Iraq, Libya or Syria. In addition, some of the most successful economic reforms of the 1980s and early 1990s were implemented under newly elected democratic governments in many regions, for instance Latin America Countries (LAC) (Bolivia, Argentina, and Brazil) and Europe and Central Asia (ECA) [transition economies like Hungary, Czech Republic, Poland, Slovenia and Slovakia among others].

The critical question is whether “better governance” is more likely to emerge under democratic or non-democratic regimes. Some of the previous discussion indicates that democracy leads to better governance, despite the risks faced by developing young democracies and countries with significant social cleavages. How about non-democratic regimes? Are they able to produce governance systems which can enhance the quality of the business environment, leading to higher investment and sustained economic growth?

Rodrik (1999) and Rodrik and Wacziarg (2005) have even argued that the performance record for democracies is even better than usually acknowledged.

Claims that democratization leads to disappointing economic results are often used to justify calls to delay political reforms in poor, ethnically divided countries until they become “mature enough” for democracy. However, the hypothesis that democratization is followed by bad economic performance, particularly in poor, fractionalized countries, is not supported by their analysis.

In any case the various cases of “enlightened dictatorship” appear to be the exception rather than the rule in the recent past. Authoritarian regimes may only randomly provide high-quality governance and for each case of non-democratic regimes which seems to produce better governance and growth outcomes one can find many more cases of bad governance and dismal economic outcomes. In probabilistic terms democracies appear to be more likely to generate better governance than non-democratic regimes.

5.3 The case of oil-producing countries

Oil rents have shielded many MENA countries from economic crises, but they seem to have also helped to reduce the likelihood for the region to become more democratic (Ross, 2001). At the same time the economic record of mineral-exporting countries over the past few decades, especially oil exporters, has been disappointing. Studies like Eifert et al. (2003) elaborate that this performance may be the result of poor public sector governance leading to poor oil revenue management. This phenomenon has sometimes been described as political Dutch disease and was noticed by political scientists in the context of the MENA region. Several authors (Wantchekon 1999, Ross 2001, and Lam and Wantchekon 2002) find a positive correlation between resource dependence and authoritarian governments controlling for characteristics such as GDP, human capital, income inequality and other possible determinants.

But can such regimes generate better governance in the absence of democracy? In fact a recent study Collier and Hoeffler (2005) finds major differences in the economic performance of autocracies and democracies when controlling for natural resource endowments. Richly endowed countries, such as oil producing countries, seem to perform better economically if they are not restrained by democratic institutions. The underperformance of oil-rich democracies is explained by economic policy choice, namely by the size and quality of investment. In view of the finding by Tavares and Wacziarg (2001) that democracies in general tend to under-invest in physical capital as they focus more on policies related to human capital development and a more equitable society, Collier and Hoeffler conclude that oil-rich democracies not only under-invest but also do so badly since they face less financial, and consequently, political restraints. Resource rich countries do not need to tax so much which results in less scrutiny on their delivery of public services by their citizens. Therefore, the key argument is that resource rich democracies need a distinctively different design which places more importance on checks-and-balances, that is, on instruments which rebalance how power is used rather than on mechanisms that determine how power is achieved.

But empirical evidence shows that major oil-producing countries tend to have lower governance indicators. While they may need to have more checks-and-balances oil-reliant countries have the worst index of public accountability scores. Having the substantial oil and gas revenues accrue directly to government budgets means that governments can maintain a deficient governance environment as long as they do some redistribution and provide public goods to the population. In a situation of “no taxation, no representation,” governments face little pressure to improve governance to increase economic development. The substantial revenue from natural resources

relieves a government from the need to tax, thus reducing its obligation to be accountable. In addition, they are able to redistribute a significant share of its oil revenue through public employment and broad access to cheap public services. These two factors —no taxation and some redistribution—help mute demands for accountability (World Bank 2003e). While the presence of mineral wealth in a country may not be the cause for a governance deficit, it could make it more difficult for good governance institutions to emerge.

Eifert et al. (2003) reinforce this conclusion and the importance of democracy for these countries. They analyze oil rich regimes in the world and depending on their characteristics, they divide political systems into (i) mature democracies; (ii) factional democracies; (iii) paternalistic autocracies; (iv) reformist autocracies; and (v) predatory autocracies. The study concludes that mature democracies have clear advantages in managing oil revenues for the long-term because of their ability to reach consensus, their educated and informed electorates, and the level of transparency that facilitates clear decisions on how to use the oil revenues over a long-term horizon. Reformist and paternalistic autocracies lack transparency and face the risk of oil-led spending being the legitimizing force behind the state, which tends to foster corruption as well as creates problems with political transitions. These countries tend to be locked in high-spending patterns that are unsustainable in the very long term. Fractional democracies lack an effective political system to create consensus among competing interests. Finally, predatory autocracies have short-term horizons and the characteristics of kleptocratic regimes that siphon money from state coffers, eventually drying up the oil wealth.

6. The “Binding Constraint” to Growth Approach

The previous review of the links between democracy and economic growth has relied mostly on work which tries to find systematic relationships from cross-country comparisons. While such research finds complex relationships and sometimes uncertain results it tends to show the existence of a strong positive relationship between democracy and growth especially if democratic institutions are designed in such a way as to lead to better governance and minimize the possible negative impact of political market failures and avoid the risks from social cleavages.

But even using such an analytical framework to try to find systematic relationships between democracy and growth Barro and Sala-i-Martin (2003) show that a non-linear relationship may exist. Democratization appears to enhance growth for countries that are not very democratic but to retard growth for countries that have already achieved a high degree of democracy. This finding applied to MENA countries would mean that democracy is important for growth given their present low scores in terms of democratic development.

A completely different approach for looking at the relationship between democracy and growth is to recognize that expectations of an overall systematic relationship between democracy and growth are ill-placed. The impact of democratization on growth should be country and time specific and the static search for a stable relationship may be counter-productive.

Such an alternative way to link democracy and economic growth is to use the recently developed approach of “binding constraint” by Hausmann, Rodrik and Velasco (2004). This approach holds that constraints to growth are time and country specific.

It rejects cross-country findings and one-size-fits-all solutions as useless tools for studying relationships between reforms and economic growth. In that framework, one has to ask the question whether at a given time and in a given country the “democracy deficit” as compared to other factors may be the binding constraint for growth. For MENA countries this could imply that democracy did not matter in the past but that it may be critical now. It may also imply that there is no general answer to this question for the “region” as a whole, but one has to be country specific.

The argument for the binding constraint approach for most countries of the region may go as follows. The low economic growth in the MENA countries is due to low private investment, which is itself due to weak investment climate and poor public sector governance. Major and credible reforms are needed, especially in terms of public sector governance and investment climate, in almost all countries of the region in order to unlock the growth potential (see World Bank 2003a).¹⁰ On the other hand, experience shows that after 20 years of attempts at reform the depth and scope of such reforms, while they vary from country to country, remain limited. Political economy analysis suggests that political regimes, as they exist, have been unable to generate the required reforms (Nabli 2005). The existing political economy equilibrium favours the *status-quo* of low public accountability and the maintenance of prevailing economic policies and networks of privilege. In such a situation democratic reform may be able to unlock this state of affairs and generate a great political and economic transformation which could produce jointly more democracy and more economic growth in the region.

7. Conclusion: Striving for Democracy in the MENA Region?

Democratization yields benefits in terms of individual freedom and empowerment that are valued independently of their consequences for growth and material wealth. But democratization is also good because democracies can (a) yield long-run growth rates that are more predictable; (b) produce greater short-term stability; (c) handle adverse shocks much better; and (d) deliver better distributional outcomes.

Our review of the literature about the links between democracy and economic growth and its application to the conditions of the MENA region leads to the conclusion that MENA countries should strive for democratic regimes which are sustainable in the sense of having characteristics which make them more likely to produce good governance. This means that democratic development requires going beyond an electoral process which guarantees free, open and competitive elections. These formal democratic processes have to be complemented with a number of reforms which aim at: (i) minimizing imperfections in the political market, with more freedom of information and free press, adequate mechanisms to contain clientelism and increased credibility of political promises, (ii) introducing safeguards and effective checks and balances, and (iii) increasing the legitimacy of the democratic transformation. In cases where there is significant ethnic and or religious fragmentation it is vital that the democratic institutions be designed so as to minimize the risks of conflict and emergence of unaccountable government.

These should help ensure or maximize the likelihood that democracy leads to better governance and therefore higher economic growth. In such a situation one would not have to face short-term trade-offs between democracy and economic growth.

Such a conclusion is reinforced by the “binding constraint to growth” approach. Democracy may not be a “binding constraint” to growth in the strict sense that if it were achieved today it would result in higher economic growth in MENA countries. However, one can argue that progress in democracy is probably critical at this stage of the MENA world’s history for achieving the required transformation which would ensure better governance, more accountability, a better investment climate and credible policies for increased private sector investment, employment and growth.

Finally one can argue that while democracy can lead to better governance and, therefore, better economic policies and credible reforms, the design of such economic reforms may in itself enhance democratic development. Producing a virtuous circle where democratic development enhances governance and economic growth will itself support consolidation of democratic development. For instance more economic openness which improves the relative incomes of the owners of human and physical capital and more economic equality would enhance the development of democracy (Acemoglu and Robinson 2006).

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NOTES

¹ The MENA region in the World Bank definition includes all Arab countries except Sudan, Somalia, Mauritania and Comoros, plus Iran.

² A recent paper by Gause (2005) reviews the question and challenges the view that promotion of democracy in the Middle East would stop generating anti-American terrorism.

³ The political regime universe has on one side democracy and on the opposite side dictatorship (or authoritarian regimes). Dictatorships are defined here as regimes in which political rulers accede to power and maintain themselves in power by force. They use force to prevent societies from expressing their opposition to rulers' decisions. Because they rule by force, they are vulnerable to visible signs of dissent. These opposing political regimes represent different ways of selecting rulers, processing and resolving conflicts, and making and implementing public policy. In a sense, they are different ways of organizing political lives. As such, they are likely to impact people's lives and welfare in different ways.

⁴ The Polity IV index is produced by the Integrated Network for Societal Conflict Research Program of the University of Maryland's Center for International Development and Conflict Management (CIDCM). Polity IV contains coded annual information on regime and authority characteristics for all independent states (with greater than 500,000 total population) in the global state system and covers the years 1800-2003.

⁵ We thank Daron Acemoglu for providing the transformed Freedom House data.

⁶ Friedman (2005) provides a useful review and summary of the findings on this issue (Chapter 13).

⁷ Friedrich Hayek (1960) summarized this point by stating that "...it is in its dynamic, rather than in its static, aspects that the value of democracy proves itself. As is true of liberty, the benefits of democracy will show themselves only in the long run, while its more immediate achievements may well be inferior to those of other forms of government."

⁸ See Acemoglu et al. (2004).

⁹ In a recent study by Harber, Razo and Mauer (2003) on the politics of property rights the authors challenge the idea that political stability and broader property rights are necessary for economic growth, based on Mexican historical evidence. They claim that economic growth does not always requires a

government that is constrained from preying upon property rights, it only needs a government that make selective credible commitments to a subset of asset holders.

¹⁰ The Middle East and North Africa Region of the World Bank produced four major regional reports on the occasion of the World Bank–International Monetary Fund Annual Meetings in Dubai in September 2003. These reports—on trade and investment, governance, gender, and employment—are intended to enrich the debate on the major development challenges of the region at the beginning of the 21st century.