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FIFTY YEARS OF FISCAL POLICY IN THE ARAB REGION

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Abstract

The paper looks at the evolution of public finance in a select number of MENA countries over the past 50 years. The review covers the size of government, how it is financed, and the composition of expenditures and revenue. The size of government expenditures has swung dramatically over time, moving from an average in the region of over 50% of GDP in the 1980s to about 25% of GDP in the 2000s. We evaluates how such changes were implemented over time and assess the current fiscal situation in light of the inheritance of the past. We also evaluate the extent to which these trends correspond to the various political economy stories used to characterize the past and the lead-up to the uprisings of 2011.

JEL Classification: P1, P2

Keywords: Fiscal Policy, Sectoral Public Spending, Political Economy of Public Expenditures, Fiscal Bulge, Arab Countries

ملخص

تنظر هذه الورقة في تطور المالية العامة في عدد مختار من بلدان المنطقة على مدى السنوات الخمسون الماضية. ويشمل الاستعراض حجم الحكومة، وكيف يتم تمويلها، وتكوين النفقات والإيرادات. وقد تأرجح حجم الإنفاق الحكومي بشكل كبير على مر الزمن، والانتقال من المتوسط في المنطقة لأكثر من 50٪ من الناتج المحلي الإجمالي في الثمانينيات إلى حوالي 25٪ من الناتج المحلي الإجمالي في 2000. نقوم بتقييم كيفية تنفيذ هذه التغييرات مع مرور الوقت وتقييم الوضع المالي الحالي في ضوء ميراث الماضي. نقوم أيضا بتقييم مدى توافق هذه الاتجاهات مع مختلف قصص الاقتصاد السياسي المستخدمة لوصف الماضي والتي سبقت ثورات 2011.

1. Introduction

While the precise role of the state in supporting development outcomes has been debated, the centrality of this role has never been contested. One of the key instruments through which the state exercises its influence is through fiscal policy (i.e., the decision by the state to finance particular state-led efforts). The choice of the level and composition of government financing supports a broad range of developmental outcomes: the size and structure of expenditures has direct and indirect effects on capital formation, infrastructure, skills, and human development, all of which are central to growth; taxation and subsidies affects incentives to invest and to use resources efficiently; developments in the civil service affect the labor market; the size and financing of fiscal deficits determine macro-stability, as well as the availability of finance for the private sector, both of which are important determinants of growth. Redistribution policies have an important impact on social mobility and on political stability

Given their impact on society, fiscal choices are eminently political. Indeed, fiscal policy is the main tool by which power is exercised, and it is also the main field in which politics is contested. As such, the analysis of the role played by fiscal policy in shaping development outcomes in the Arab World over the past 50 years requires a broad political economy lens that encompasses not only economic dynamics but also the way in which the state evolved, income distribution changed, and social movements emerged. From the perspective of the social and political transformations that are today blowing in the region, an exploration of the trajectory and broad characterization of fiscal policies in the past can reveal much about how power relations have evolved, and about the underlying social grievances that have led to the constitution of the popular movements that have been rocking the region since 2011.

Fiscal policy in the MENA countries has gone through dramatic changes over the past 50 years, with state expenditures initially growing to extraordinary levels, and then shrinking enormously. Both the nature and sheer size of both the rise and fall colored in important ways the economic and political history of the region. From small post-independence states, to the rising nationalist states, republics and kingdoms alike, state expenditure rose to reach 50% to 60% GDP in most of the region during the 60s and 70s, in line with the high levels of state activism and ambitions of the time. In the late 1990s, however, the size of the state had shrunk, on average to 25 to 30% of GDP, reflecting to a large extent the drying up of sources of finance that had allowed and supported the previous rise of the state.

This “fiscal bulge” was due to three main factors, in various combinations depending on the country. The first factor is related to the change in the development models followed, which was state driven in the 1950s to the 1970s, until this mode of development became inefficient and unworkable, and had to be discontinued, leading to a long period of forced adjustment, which in many countries lasted well until the 1990s. The second important influence is the price of oil, with the peaks of the 1970s and lows in the 1980s-90s affecting oil exporters and importers alike, the latter because of fluctuations in the amount of aid received from oil exporters and in workers’ remittances. The third factor is political, with the socialist regimes of the 50s having been gradually replaced by regimes that implemented market liberalization reforms and who sought the political support of the business elite as well as of the middle class instead of their traditional constituencies of farmers, workers, and civil servants.

Changes in fiscal policy have typically been gradual, with the “bulge” lasting over 20 years, and the rollback period often taking more than a decade. But over time, the impact of the transformation of fiscal policy on the economy, society, and polity has been massive. Now that political winds are changing in some countries, fiscal policy reforms will have to play a central role in the reform programs of new governments. However, how far the roll-back of the state has gone and how challenging the inheritance of the past is are issues that remain

poorly understood -- there are surprisingly few studies that have traced the drivers, trends, and the impact of fiscal policy in a region-wide comparative manner.

The goal of this paper is to start doing so, in order to scope out the issues that need to be looked at in more detail in a subsequent ERF research program. The paper looks carefully at the evolution of public finance in a select number of MENA countries for which we could reconstruct detailed fiscal accounts over long periods (typically 1960-2010); evaluates the changes that have occurred over time; and assesses the current situation in light of the inheritance of the past. This review will cover the size of government, how it is financed, and the composition of expenditures and revenue. We also evaluate the extent to which these trends correspond to the various political economy stories used to characterize the past and the lead up to the uprisings.

The paper has four goals: (i) to clarify the magnitude and structure of change in fiscal policy in MENA countries since the 1970s; (ii) to understand the exogenous, structural, and political drivers of these changes; and (iii) to investigate the structure of the fiscal adjustments, and try to draw some of the political economy consequences of the choices made; and (iv) to start to tease out the policy implications now that political circumstances have changed in several of the countries of the region.

The paper is organized in five main parts. After reviewing the literature and explaining how we constructed our fiscal database in section 2, section 3 looks at the growth environment. Section 4, which is the heart of the paper, looks at the changing composition of state expenditures and revenues, and the impact these have had on a range of development outcomes. Section 5 concludes by discussing the implications of the inheritance on the future.

2. The Issues and the Literature

It is surprising how little fiscal accounts are covered in the main texts dealing with the political economy of the region, such as Richard and Waterbury (2006), Henry and Springborg (2010), or Noland and Pack (2007). Published country studies describing fiscal policy in detail are rare, and this reflects the nature of studies on the Middle East, which have been dominated by political scientists with little attention paid to numbers.[1]While the World Bank and IMF often publish country reports (Article IVs and Public Expenditure Reviews), with a few exceptions (e.g., IMF reports on energy subsidies (2013)), or counter-cyclicality of fiscal policy (IMF 2010), these country accounts are rarely aggregated into more systematic analyses of cross cutting issues, and when they do, they tend to be global as opposed to regionally focused, and as a result, they do not get into the political economy drivers specific to the Middle East.

Indeed, the dearth of recent reviews of fiscal trends in Arab countries has even the area specialists confused about the magnitudes of the changes that have occurred over the past several decades. For example, some claim that the recent uprisings in Tunisia and Egypt were due to the rollback of the state, while in fact, this has happened in most countries more than 20 years ago. The region had been recognized in the past for its fast progress in health and education (e.g., Kuhn 2013). Yet recent views stress more recent failures, reducing social mobility (UNDP 2013). Has expenditure on social services been reduced or has it risen over time? Some claim that public sector wages are too high (e.g., Assaad 2009), crowding out the private sector, but others claim that they are too low, feeding petty corruption (e.g., Hartman 2008 on education in Egypt). Again, looking at the long term development in the wage bill should shed important light on this issue. Subsidies are making the headlines, and they have increased recently, but some still believe that food subsidies are large, when in most countries they are dwarfed by energy subsidies that benefit the richer part of the population (IMF

[1] One such study on Egypt is Soliman (2011).

2013). Policy advice tends to insist on cutting subsidies without recognizing the political role they play.

In theory, when focusing on economics alone, fiscal policy is in the most extreme neutral, under the Ricardian equivalence principle (see Frankel 2009, for example). In more realistic conceptual set-ups, fiscal policy is seen, de minimis, as helpful in smoothing shocks, given that taxation is distorting and frequent adjustments in the size of public expenditures is bound to be costly on several accounts. A more realistic set-up, however, recognizes that fiscal choices are at the heart of the development. There are relations between fiscal policy and growth, and vice versa, and between governance and fiscal policies, again running on both directions. Let us briefly review these links.

From a development perspective, the main issues when evaluating fiscal policy are over levels, composition, balance, and variability. Are spending choices effective in driving growth and attaining desirable social outcomes? From a strategic perspective, are the choices made over development strategies, including on the trade orientation, and on the private sector, workable at particular historical moments? Are social services effective and is social protection worth the expense? Fiscal imbalances can be bad for growth, as this generates macro instability that not only hurts the poor, but tends to delay private investment. There is a risk of low growth traps when shocks hit that cannot be adjusted to rapidly. The oil shocks experienced in the region over the past 50 years are a classic example of such long term variability, which has sent tremors in the economy and in society.

The other set of relations runs from fiscal policy to governance and both directly and indirectly to development. In Latin America, and in response to the large fiscal shock of the mid-1980s, governments not only liberalized their economies, but also their polity. This did not happen in the MENA region, where instead, political space became more closed, and authoritarian governments chose to co-opt some parts of society, especially the middle class, while increasing the repression of others, especially the poor, to ensure their political survival (Cammett and Diwan 2013). This particular regime, authoritarian with alliances with the business elite and with a liberalizing economy dominated by cronyism, has had important fiscal implications, especially in the way budgets were reorganized to make room for subsidies, benefitting the richer part of society at the expense of the quality and quantity of public services. The main indirect impact of this political-economy regime on the fiscal accounts relate to the growth of the informal sector and low growth of the formal economy, which negatively impacted tax revenues.

From a broader perspective, one can also investigate a set of issues related to the timing of stabilization. Why were stabilizations delayed in the region? What was the role of external donors, strategic rents, and oil in allowing for a delay of reforms – it had become clear in the 1970s that the import substitution model had failed, but it was only in the 1980s- and 90s that reforms were initiated in the region. Moreover, with the second oil boom that started in the early 2000s, many countries with oil revenues have slowed down their reform effort, as in Syria, Algeria, or Iran, while others, and in particular Saudi Arabia and the rest of the GCC, started rolling back their reform programs after the Arab uprisings, in an attempt to reassert control over their societies.

Indeed, several aspects of fiscal policy in the region are connected to oil. The Dutch Disease is after all a fiscal phenomenon, related to the structure of government spending (Beblawi and Luciani 1987). But oil-based growth creates its own types of economic and social challenges, let alone political challenges. First, export revenues accrue to the state. Second, oil exports lead to a change of relative prices that discourages economic diversification. And third, they depend on oil prices and are therefore highly variable. These effects can foster stagnation of the agricultural and manufacturing sectors, while government and the building industry

boom, at the expense of the manufacturing private sector. Moreover, the international movements of oil prices can lead to a succession of boom and bust periods. There is evidence of such effects in the Middle East, as elsewhere, most notably in the fast fall of agriculture and in the difficulties of creating a vibrant manufacturing sector. But good policy can, in theory, reverse these nefarious effects: expenditures can be smoothed by placing revenues in an oil fund; oil revenues can be used to strengthen the sectors that get weakened, for example skills and infrastructure, can be subsidized to increase the productivity of the tradable sectors. Fiscal policy, then, is at the center of efforts to cure the disease, and the cure has varied considerably from one country to another.

There are related and little explored issues relating to the extent to which fiscal policies have been pro-cyclical (see IMF 2013) or not. Economic explanations as to why the smoothing of expenditures does not happen are not convincing (liquidity constrained during busts, creditworthy during booms) – as a strategy of saving/dis-saving is always feasible. Some explanations offered for why smoothing does not occur relate to the possible existence of electoral fiscal cycles (there is one study for Egypt, Blaydes 2008). Other explanations, in the oil curse political economy literature, relate the lack of counter-cyclical fiscal policy to the increased value of "power" when natural resource price rises elicit more spending to stay in power (Robinson et al. 2010). Yet another hypothesis relates the lack of smoothing to perceptions of corruption – when oil prices are high, the population puts pressure on rulers "to show the money," as saving is associated with stealing (Alesina, Campante, and Tabellini 2008).

Fiscal policy is often at the heart of political models of class struggle. One particular class of models of interest after the Arab uprisings is the distributional model that can explain revolutions. Acemoglu and Robinson show how distributional concerns -- the rich wanting low taxation, the poor wanting to tax the rich and redistribute – can lead to democratization (Acemoglu and Robinson 2006; de Boix 2014).[2]Diwan (2013) develops this type of argument to interpret the uprisings of 2011 as a situation where the middle class decided to switch sides because of both grievances related to rising unemployment, and aspirations related to rising levels of education.

When discussing fiscal policy from a macro perspective, a focus on the balance of payment - the external constraint - is equally important. Typically, this is the constraint that tends to be more binding, since governments can usually finance their fiscal deficits internally with money and domestic credit as long as the external balance holds. BoP adjustment – and in particular devaluations – have important fiscal costs as when governments need to extend subsidies to smooth the cost of price increases (energy, food), or when external debts become more expensive to service.[3]

3. Data and Country Grouping

One of the main difficulties in putting together a long history of fiscal policy in the region is that the fiscal accounts, as available from national sources and from the IIFs, tend to only start in the 1990s, when most of the region turned to the IIFs to support their macroeconomic and structural adjustments. As a result, the main contribution of this paper is an effort to reconstitute the fiscal accounts since the 1960s.

[2] If inequality is not too high, and especially if the middle class sides with the poor, a more democratic regime would ensue – here democracy is a commitment to tax according to the preferences of the median voter as promises by the elites to increase taxation in return for demobilization not being time consistent. If inequality is high, however, and repression costs are low enough, the elites will tend to fight back, including by increasing repression and trying to co-opt the middle class to prevent it from switching sides.

[3] But the large devaluations in the region have often occurred in the context of debt reductions, reducing the importance of this last effect.

Such a task is problematic. The key source of information we use is the IMF Government Fiscal Account Tables. The data is both spotty, especially before 1990s, and the classification of various types of expenditure varies across countries and across time. There is little data for countries that have not had close relations with the Fund. For example there is no data for Iraq, little data for Sudan, and very little data for Yemen before its unification. Similarly, there is no data for the West Bank and Gaza pre-PNA, and no data for Lebanon pre-1990. The accounts of the oil producers of the GCC are not covered systematically by the Fund. As a result, the countries which we are able to document in some detail are restricted to: Morocco, Tunisia, Algeria, Egypt, Jordan, Palestine (only for 2005-11), Lebanon (only 1990-2010), Syria, Iran, Turkey, Yemen, with some partial coverage for the countries of the GCC.

Another source of complication is the predominant role of the state in production, and especially the operation of Public Enterprises. But GFS does not cover public enterprises and so we are restricted in our coverage to the accounts of the general. This leaves aside the many ways in which governments exercise influence through off-budget or extra-budgetary spending. Similarly, military expenditures and off-budget subsidies – such as energy subsidies in oil producing countries, tend to have low or no coverage (see Amigo and Hertog 2010).

The classification used by the GFS database is complex and our task has been to simplify it into a form that can be readily analyzed around simple analytical concepts and variables. The GFS Database and the GFS-Historic Database are the two main sources that we use. The former database covers the period between 1990 and 2011, while the latter covers 1972 to 1989. These databases differ not only with respect to their years of coverage but also in terms of accounting rules, analytical framework and degree of details. The GFS is prepared in line with the framework of the Government Finance Statistics Manual, 2001(GFSM 2001) is mostly recorded on an accrual basis, and includes cash and non-cash data. The database also allows the user to extract detailed revenue, expense, outlay, acquisition of financial and non-financial asset tables for most of the countries. Moreover, the sector decomposition of the data includes detailed information about central government, local governments, extra-budgetary operations and social security funds. As noted above, public corporations are not included in the database.

On the other hand, the GFS-Historic database is comparatively limited in coverage and in detail, though this dataset also provides information about revenue, expenditure, lending minus repayments, financing, and debts of central government, social security funds and extra-budgetary operations. The GFS Historical database is prepared in line with the framework of the Government Finance Statistics Manual, 1986 (GFSM 1986) that is mostly recorded on a cash basis. Moreover, it uses a functional definition of public entities rather than an institutional definition as in the GFSM 2001. In spite of the fact that the GFS and the GFS-Historical databases differ in some respects, their coverage (general government) is more or less the same and this allows us to produce long time series by combining these two datasets. We are, of course, aware of the differences of coverage and possible breaks in the data resulting from the definition change after and before 1990, so other checks are also employed to see whether the data is consistent between these two databases, including looking at national sources for consistency checks and to "glue" together distinct time series.[4]

[4]We also use other sources to make adjustments to the data, in particular cases. For example, we will use energy subsidies information from the IEA. Public investment data from the WDI is used as a comparator, but the differences in definition between the two sources will be noted. We supplement the GFS data with Defense expenses data from SIPRI. We take privatization receipts data from the WB Privatization Database.

4. Three Types of Countries

Rather than discussing each country of the region on a case by case basis, we find it more useful to classify the countries of the region into a typology that we find analytically useful. The region has about two-thirds of the world's oil, nearly all of which was in the Persian Gulf (OPEC 2005). Over half (about 57%) of all oil reserves are in the Gulf, while Saudi Arabia alone has about one-quarter of all the oil on the planet. Since one important difference is how much a country relies on oil, this offers a natural way to classify countries in a typology that has some analytical teeth. As argued throughout this paper, there are important differences, both political and economic, between oil and non-oil countries on the one hand, and among oil rich countries between those with large, and those with relatively small populations. The first group has low oil per capita and the other two have medium and high oil per capita. So we divide our countries into three groups, depending on their level of oil per capita, with the threshold picked somewhat arbitrarily at US$450, and US$5,000. We get the following groups:

- Resource Abundant Labor Poor (RALP) – essentially GCC countries, with Libya at the margin of this group (its oil per capita at about US$11,000 in 2010 is lower than in all the GCC countries, with Saudi Arabia, with US$23,000 per capita being the distant second lowest in the group);
- Resource Abundant Labor Rich (RALR) – Algeria, Iran, Iraq, Sudan, Syria, and Yemen. We note that Syria, Yemen, and Sudan are in this group, but not Egypt and Tunisia, although their oil per capita figures are not largely different (US$250/330 for the first group vs. about US$170 for the second).[5]
- The Resource Poor Labor Rich (RPLR) – Egypt, Jordan, Lebanon, Morocco, Tunisia, and the West Bank and Gaza (WBG).

This taxonomy is meant to be only suggestive; its boundaries are porous. For example, Egypt and Tunisia used to derive larger rents from oil in the past (19% and 9% of their GDP in the 1980s respectively), but these have fallen in the most recent period (to 7.8 and 3.5% of their GDP respectively in the 2000s). Syria also used to derive sizable revenues from oil, and while this has fallen, it remains relatively large. Unless important new discoveries are made soon, dwindling Algerian oil reserves will turn that country into an RPLR in a generation. Syria, Jordan, and Egypt collect rents on their strategic locations, and Morocco's exports are dominated by phosphates (30%). Sudan's and Yemen's oil wealth is recent.

Interestingly, these categories are also sharply differentiated in their governance indicators. Cammett, Diwan, Richard, and Waterbury (2014) look at an array of governance indicators, including the rule of law, government effectiveness, perceived corruption, repression, and empowerment. They all point to a consistent pattern: The resource-rich, populous countries exhibit the most inferior outcomes in comparison with the other country groupings in the Middle East. Conversely, the RALP countries consistently show relatively high values on all governance indicators except empowerment, although there is more internal variation in this category. The RPLR countries are similar to the RALP on most governance indicators, save their weaker rule of law and state capacity. These trends hold with respect to economic growth and development trajectories, as we will see below.

It thus seems that the alleged oil curse does not apply as a blanket rule across the region -- it afflicts the labor abundant countries far more than their sparsely populated wealthy counterparts. Algeria, Iran, Iraq, Sudan, Syria, and most recently Yemen are characterized by institutional environments that are least conducive to fast growing development trajectories in

[5] However, these countries are more clearly different when one looks at the relative importance of oil in the economy, as reflected by the oil/GDP ratio for example -- the first group has levels of oil/GDP in the range of 20%, while for Egypt and Tunisia, the ratio is well below 10% GDP.

comparison with the RPLR and RALP countries. Virtually all of the RALR countries adopted populist policies at independence, but when these failed in the 1970s and 80s, autocrats were unable to shift to patronage, unlike the monarchies of the Gulf, for a lack of sufficient resources, and had to resort increasingly to repression in order to survive.

5. The Growth Context

Fiscal policy affects growth through the several channels listed above, including macro stability. Revenues and some expenditure are themselves affected by growth. Here we provide the broad growth background, which varied by countries and phases of development, in which fiscal policy evolved over the past 50 years.

For the region as a whole, and over the long period 1960-2010, there is nothing special about economic growth. The long-term rate of GDP growth of the region over the past 50 years stands at 4.9%, a bit higher more than the world middle income countries average (4.7 %) and more than the world low income countries average (3.4%).[6]When comparing the MENA to other regions of the world, it grew at about the same average rate as South Asia (5%), at a much faster rate than Africa (3.5%) or Latin America (3.8%), but at a much slower rate than East Asia (7.3%).On a per capita basis, GDP growth was much less impressive, at approximately 2.2% over these fifty years, below the middle income group (2.8 %), and about 50% of East Asia's stellar performance (5.6% per capita per year over the whole period).[7]

It is indeed striking how large the variability of this growth has been over time. There are several causes for this variability, including the relation between economic growth and the price of oil, the costs of socio-economic adjustments as much of the region moved from state led to market led economies around the 1990s, and the effects of various wars which had devastated the economies of particular countries. The one period with the lowest economic growth rate was somewhere in the 1980s-1990s, when most of the countries experienced a "lost decade." The lost decade, which in some cases was shorter and in others longer, coincided in most countries with the height of the youth bulge, when the share of labor entrants to total population was at its maximum. In other regions, and in particular in East Asia, this created a demographic dividend, as the labor force grew faster than the population thus providing an extra push to GDP per capita. In the Middle East however, the coincidence of the youth bulge with rough economic times complicated matters further and led to rising social frustrations, ultimately leading to the 2011 uprisings.

There are also many differences among the countries of the region, as shown in Table 2. If we focus on GDP growth (GDP per capita is low in the RALP group because the huge influx of foreign workers distorts the "per capita" aspect), it is apparent that the RALP group did best, growing at 5.6% a year, a remarkable average over this long stretch of time, and the fastest growth rate for any single region besides East Asia. Given the huge contribution of oil wealth to this growth, this performance is perhaps not too surprising, but it does stand in sharp contrast with notion of a "resource curse." More surprisingly, it is the RALP group that comes second, with a good performance by global standards of 5.3% growth, but a per capita performance of 2.8% only, which while weaker, remains nevertheless at the MIC average. The RALR region, which is rich in both oil and people, comes a distant third place at 4.4% average growth per year, and at only 1.3% on a per capita basis. This reinforces the

[6] The regional and group averages in this paper are un-weighted averages over time and over countries. We use un-weighted averages because our goal here is to illustrate the performance of an average country rather than an average Arab citizen.

[7]If we computed GDP growth on a per labor basis, instead of on a per capita, the regional performance would look even worse, since the labor force grew faster than population until the early 2000s in much of the region. In many countries, and especially when the youth bulge was at its height around 2000, the rate of growth of output was not sufficient to keep up with the growth in the labor force—which was above 3% during the 1990s. As a result, in many countries, average wages are today at levels not too different from where they were in the 1970s (ILO 2013).

conclusion that this middle group of country seems to have bit hit most by the oil curse. Interestingly, the countries exhibiting the lowest performance are those that were believed in the past to show the greatest promise, as they could combine oil wealth with a large population to develop into industrial giants. Iraq, Iran, and Algeria all had such dreams and plans. However, when their industrialization drive ended up in failure in the 1980s, they all got mired in internal and external conflicts that ended up undermining their economic potential. Syria has just entered such a destructive phase.

5.1 Oil price variability

These variations over time in economic performance were due to in part to oil prices, and in part to the effects of the structural adjustment period of the 1980s. The two factors actually interacted in several ways. Oil prices experienced two main periods of boom: one in 1973-79; and the other more recently, in 1998-2014 (at this writing). The course of oil prices and oil revenues is shown in Figure 1. Oil prices are expressed in constant 2010 dollars, so that they can be compared over time. The two peaks of 1973-79 and 2007 are apparent. The figure also depicts the regional oil revenues over time. The first oil boom had spectacular effects: as oil prices quadrupled between 1972 and 1979, reaching nearly US$100 per barrel (in 2010 dollars) in 1979, oil revenues in the region jumped from less than US$100 billion in 1972 to over 700 billion of (2010) dollars in 1979. The second and more recent boom is equally if not more spectacular, bringing the region about US$900 billion in direct oil revenues. In between, though, there was a long period when oil prices oscillated between US$20 and US$40 (again in 2010 dollars) and revenues were around US$200 billion a year only. These are huge variations with equally huge effects.

Oil production represent and important share of the gross national product in both RALP and RALR countries. It is interesting to observe, however, that while in per capita terms, oil revenues grew much faster in the RALP countries, oil production as a share of GDP grew faster in the RALR countries, reflecting the fact that the first group increased diversification over time, while in the second, diversification decreased over time. The oil importers benefitted from high oil prices too, even though they had to pay more when they imported oil.[8] Both remittances and aid from oil producers went up and down with oil prices, which explains why the importers' fortune also followed the same cycle of boom and bust. First, poorer countries, and especially those of the Mashreq region (and in particular Lebanon, Jordan, WBG, and Yemen), benefitted from large remittances by their workers that flocked to the oil producing countries, especially during the 1970s and 1980s (see Table 3). The sheer size of migrant workers sets the region apart. Jordan, Lebanon, and the WBG received between 8 and 13% of their GDP from such sources, while Morocco and Egypt received about between 5 and 10%. Second, ODA rose, in part due to support by GCC countries, and especially during oil booms, with the front-line states of Jordan, the WBG, Egypt (until its peace agreement with Israel in 1982), and Syria being the largest beneficiaries of this aid. Added to this is Western aid, especially from the US, first to Israel and Egypt, then to Jordan, and more recently to Iraq, the increased involvement of the EC in the region under the guise of the Southern Mediterranean program, and the involvement of the international Financial Institutions, with the IMF most active during economic crises. As a result, most countries of the RPLR type received generous support to the tune of 5 to 8% of GDP over much of the period, which on a per capita basis represents one of the largest levels of support globally (Malik and Awadallah 2013).

5.2 Three phases of development

It is useful to contrast how our three types of countries behaved differentially over the three phases of development experienced by the region in the past 50 years – growth in the 60s-

[8]Some RPLA countries such as Egypt and Tunisia had some oil production as noted earlier.

70s, bust in the 1980-90s, and a renaissance of sorts in the 2000s – as the similarities and differences in their fiscal behavior reveal stark differences, both structural and political, between these three groups. In the first phase, economic growth and structural change proceeded briskly in the region in the first two decades after 1960 – initially because statist policies work for a while before running into contradictions, and later, because the first oil boom in 1973 allowed states to continue with such policies after they had run their course. The second phase, during the 1980s and parts of the 1990s was marked by the collapse of oil prices, which forced policy adjustments and resulted in a "lost decade." The third phase, which encompass the past fifteen years until the uprisings of 2011, growth has resumed in most countries, and when it seemed to start to taper off, it was boosted by the second oil boom after 1998. These periods were partly due to, delayed, or exacerbated by the important effects of the oil cycle, which affected all countries, including importers through remittances and regional aid. Let us now look at each of the three phases in more detail.

The rising 1960s and 70s. In the early phase of post-independence development, growth in the MENA region was among the highest in the world. In the 60s and 70s and until the early 1980s, growth shot up, from the relatively low levels experienced during the 50s, benefiting from the early phase of the state led development model. This period was the height of a movement that started earlier in the 50s with the rise of nationalist states and the middle class, investments in human development, and dynamic growth policies fashioned on the Turkish Ataturk model. Economic growth was rapid at 3% to 4% a year on a per capita basis, reflecting high rates of investment and accumulation, as well as increased productivity linked to investment in human capital. Oil exporters did particularly well, boosted by the extraordinary rise in oil revenues after 1973. Iran (in the 1960s) and Saudi Arabia (in the 1970s) grew at above 7% per capita. But others also benefitted from the regional tide, with Syria, Jordan, Tunisia, Lebanon, and even the West Bank and Gaza growing at rates above 5% a year over for much of the two decades. The period of fast growth could not be sustained. Not all Middle Eastern countries adopted import substitution, but for the many that did, the 1970s brought a far-reaching reappraisal of what they had undertaken. As elsewhere in the world (and in particular, like in Latin America), state-led industrialization strategies focused on import substitution faltered after an initial period of fast growth. Shielded from international competition and mired in bureaucratic inefficiencies, labor productivity remained low, and the region did not take advantage of the fast growth in global trade, like East Asia did.

Adjustment and the lost decades of the 1980s-1990s. For most of the RPLR countries, the moment of truth was brought about by the increase in their petroleum import bill after 1973. Many countries of the region attempted to delay adjustment by borrowing only to face the day of reckoning a few years later. In the 1980s, the debts of the RPLR countries grew immensely as they resorted to international debt in order to delay adjustment. In the RPLR countries, the average debt to GDP ratio of this group stood at over 100% in the late 1980s.[9] In the countries with abundant oil (Algeria, Iran, or SA), oil revenues and external borrowings allowed for delaying adjustment until later in the 1990s. But the collapse of oil prices of the mid-1980s sounded the death knell of ISI in the region (see Tables 5a and 5b).

The first countries to start adjustment were Morocco (1985), Tunisia (1986), and soon after Jordan (1989), Algeria (1989), followed by Egypt (1991), all of which adjusted in the context of a series of IMF programs backed by the World Bank and other Western Donors (see Annex 1 for a list of IMF programs). Other countries adjusted without the recourse to an IMF

[9]The internationally recognized dangerous zone for external debt starts at around 50% GDP – countries become vulnerable to external shocks, sudden stops of capital flows, and financial crises.

program, such as Saudi Arabia (in the mid-1990s), Iran, Syria, and later, and in a different context, Sudan and Lebanon.

The timing of stabilization was dictated much more by the availability of finance, than by any ideological decisions to reduce the size of the state, as had happened in the UK and the US with the Reagan and Thatcher revolutions. With the partial exception of Morocco and Tunisia, which took an early strategic decision to develop strategies in sync with the attraction of exporting to the European markets, for the other countries, the adjustment posed the question of development model, and so, it was resisted as long as possible. In some cases, countries sought to make good on strategic assets they possessed – for example, Egypt's two major adjustment programs coincided with the Iraq war in 1990 and the Gulf war in 2000. Similarly, Jordan adjustment coincided with its peace agreement with Israel. In both cases, generous financing allowed for a slow and gradual adjustment over time. Countries that adjusted without a Fund program could either afford to (Algeria, Saudi Arabia), and/or were unwilling to subject themselves to Western policy interference given their political alliances (Sudan, Iran, Syria).

The content of the programs tended to be similar – this is a known area, which will not be discussed in detail here. Public expenditures were slashed, emasculating the welfare state, and reducing social mobility. The macro-imbalances were restored over time and economic growth was restarted by the mid-1990s. On the structural side, most of the region started to move in the direction of export-led growth and of private initiative. The foreign donor and creditor community pushed in this direction. To have any chance of success, this strategy requires that factors of production, essentially labor and capital, to move from decaying sectors towards sectors of production that would be more efficient and that could compete abroad. The Washington Consensus "theory" was that the reallocation would be best achieved by the market mechanism. As a result, the strategy called for trade to be liberalized, public enterprises to be privatized, the financial sector to be opened up, and national currencies to be sharply devalued to encourage exports. There were daunting domestic challenges to this strategy. Political difficulties of transitioning from an IS to an export-driven strategy are compounded when the starting position is one of gross inefficiencies in production, as was the case in the Arab World (as well as in Latin America and Eastern Europe when they started their own reforms). In contrast, in the East Asian NICs, IS had performed better, laying the ground for a smoother passage to competitive export.

The transition costs were large and have marked the political economy of the region ever since, playing an important role in the genesis of the Arab uprisings of 2011. Growth fell deeply in the 80s and 90s -- the lost decade lasted typically longer than elsewhere, but there were significant differences among countries. Viewing the 1980s as a whole, GDP per capita growth was -1.0% a year in the RPLR countries (Egypt, Jordan, Morocco, and Tunisia), -0.6% a year for the RALR countries (Algeria, Iran, Syria, and Yemen), and -2.0% in the wealthy RALP countries.

The third phase and recent growth and the context of the Uprisings. Structural adjustment and macro stability did yield some benefits. Once the macroeconomic situation stabilized by around 2000, the private sector was put in charge of economic growth, and indeed, growth picked up in most of the countries of the region. Between 2000 and 2010, several countries grew at above 3% on a per capita basis (Egypt, Iran, Jordan, Lebanon, Morocco, Sudan, and Tunisia). Turkey has grown more slowly than its regional income group average, but it had adjusted earlier in the 1980s, and saw longer periods of uninterrupted growth which over time raised its income levels significantly.

Pro-market reforms, which accelerated in the 1990s in most of the region, started to transform the region into private sector driven economies. By 2010, on the eve of the Arab uprisings,

the regional landscape was radically different from that of the 1980s, with the public sector much smaller, and the private sector dominant nearly everywhere. In other regions, such as Latin America and sub-Saharan Africa in the 1980s and 1990s, economic crises had helped to provoke regime change during the near synchronous "third wave" of democratization (Huntington 1991). In the Middle East, however, autocratic rulers did not open up the political space in order to reduce social pressures stemming from the decline in economic resources. To the contrary, in 2010, the region was less open politically than it was in 1980, and this is true of the three types of countries. Instead, the political settlements adjusted to the new realities of more scarce external rents.

In the RPLR countries, the new arrangements did not lead to competitive and dynamic markets, and as a result, growth remained modest. The old regimes reinvented themselves as market friendly, and created new rents in the guise of "regulation rents" – rents that accrue as a result of privileges and exclusion mechanisms (Malik and Awadallah 2013; Heydeman 2004). As a result, the quality of economic growth deteriorated -- it was much less inclusive than in the past, the private sector became increasingly informal, monopolies and privileges rather than competitive markets became the rule, and there was little trickle down and rising income inequalities. In response to growing social malaise at the loss of a credible development path, and the rollback of the welfare state and its services, which weakened social mobility, the increasingly autocratic regimes enforced their dominance through repression (sticks) and economic co-optation (carrots), to maintain the support of the middle class. Divide and rule strategies, based on a combination of blanket subsidies and repression as well as fear mongering about political Islam, were the foundation of an increasingly fragile governing coalition. Supported by the West, this autocratic, low equilibrium lasted for two decades. But mounting fiscal pressures, driven in large parts by rising subsidies and lower tax revenues, led to deteriorating social services and lower public investment, further hurting the poor and peripheral regions and leading to increasing identification with the poor rather than middle classes among populations. In this context, the Arab uprisings of 2011 was led by middle class elements that defected from authoritarian coalitions and evolved into champions of change, driven by the lack of opportunities for socioeconomic advancement and anger about perceived rising inequalities.

Our typology of resource rich countries distinguishes between those oil and mineral exporters that have other resources, and in particular substantial populations (and thus, considerable agricultural potential), and those whose economies are entirely dominated by mineral exports. It may seem that state-led industrialization was a perfectly reasonable approach for countries that have significant nonpetroleum resources, but it is much more difficult to imagine what economic future is in store for the Gulf States after their oil runs out. The absence of arable land, water, and nonoil mineral resources and the presence of a small, poorly educated population suggest that the future without oil may be bleak. Oil exporters of the first group however, such as Iran, Algeria, and Iraq should be able to use the large oil revenues to industrialize. That this simple economic intuition did not turn into reality is a testimony of the importance of politics in shaping development paths –Iraq, Iran, and Algeria have all failed in translating their considerable potential into reality, as they were unable to adjust their production structures once state-led growth faltered in the 1980s.

As oil revenues fell, repression levels rose in the RALR countries, and the economy continued to stagnate. The cautious reforms that were undertaken at the heart of the crisis were quickly reversed as soon as oil prices started to rise again, for example in Syria, Algeria, and Iran.

On the other hand, the oil rich/labor poor countries have had more success on the economic front, despite what seemed a priori as a more difficult bet. This was in part the result of the

ability of these countries to ensure high levels of domestic consumption at home through large subsidies, which has brought political benefits in the form of popular support and political stability. This was, moreover, complemented by a successful economic strategy, which was built on four pillars. First, these countries have massively imported labor, their main scarce factor, and they have even imported institutions in the form of the world's top consultancy firms. The large availability of both capital and labor have allowed for a quick expansion of infrastructure, leading to one of the most massive construction booms in economic history, despite numerous bottlenecks which were inevitable given the low initial level of infrastructure and the size of the projects.[10] Second, their deeper pockets have allowed for some stabilization policies to smooth the oil shock. When they were hit by the long period of oil slump in the 1980s and 1990s, these countries had accumulated sufficient financial assets to serve as a shock absorber and a reliable source of income. Third, they manage to invest highly in both capital- and energy-intensive petrochemical industries and to start to diversify away from oil -- today, Saudi Arabia is the largest exporter of industrial products in the whole region, and the UAE has been able to develop a service sector that is globally competitive, often managed as public enterprise islands of quality (Hertog 2012).

6. The Collapse of the Expenditure Bulge of the 1970s

The last 20 years have seen a slow transition, not just from state-led to market-driven growth, but also from a very large to a much smaller, but still large, and much impoverished state (outside the RRLP countries). While the first transformation has directly affected the process of job creation, the second has affected the economy indirectly through the fiscal channel via: capital formation, infrastructure, skills, and human development, taxation and subsidies, developments in the civil service, and redistribution policies.

A look at the level of state expenditure for the region as a whole and the 3 sub-groups, from the 1960s to 2010, depicted in Figure7 shows clearly that the rollback of the state began in the 1980s. Government expenditure shot up in the 1970s in our three groups of countries, on the back of rising oil wealth in the region, but they fell precipitously in the 1980s before stabilizing in the 1990s at much lower levels. So while state expenditure exceeded those in other global regions during the whole period, unlike all other regions, they exhibited a downward trend in the past two decades. It is noteworthy that all countries started to increase expenditures again during the more recent second oil boom.

It is in the RPLR countries that government expenditures decreased most dramatically. On average, state expenditures peaked in the early 1980s at about 50% GDP, but by the early 1990s, they were down to about 30% GDP. In these countries, adjustment tended to be slow and gradual, because it was supported by the IFIs, and it only concluded in the late 1990s. The roll-back of the state had a dramatic impact over time on some of the main services offered by the state, and since the 1980s, public welfare institutions have declined steadily, affecting all segments of the population, but particularly damaging the poor who rely on government services to support their social mobility.

State expenditures exhibit the same pattern of rise and fall for the other two types of countries, the RALP and the RALR. In the first group, adjustment started later, in the mid-1980s, when expenditures stood at over 55% of GDP on average. The decline was slower, but expenditures also reached a low of about 30% GDP by the early 2000s. It is noteworthy that the early 2000s also witnessed low oil prices and thus low GDP – so the effect of the low ratio of spending to GDP is compounded by low GDP. In the RALR countries, the rise of state expenditures came earlier, reflecting the early industrialization push in Iran, Iraq, and Algeria, and the decline started earlier as well, partly because of the effects of a war economy

[10] Free import of labor, and a liberal policy on remittances, allowed the GCC countries to avoid Dutch Disease problems (Espinoza et al 2013).

in Iran and Iraq, and partly because these countries received very little international support to smooth their adjustment. In these countries, the expenditure "bulge" was as dramatic as in the RPLR countries, reaching a peak of 45% GDP in the mid-1970s, and falling below 25% GDP in the early 1990s.

To get a feel for how this enormous fiscal adjustment was achieved, we have constructed a table that shows the composition of state expenditures at the peak of state expenditure and at its bottom, for each country of the region- see Table 8. For example, it shows that in the case of Egypt, the highest level of expenditure was 61.5% GDP in 1982, and its lowest was 25.1% GDP in 1998. The "fiscal bulge" then was enormous at 36% GDP. The following tables show the size of some of the main budget items – public investment, civil service wage bill, expenditures on health and education, subsidies, and military spending – in the same years where expenditures peaked and then hit the bottom of the bulge, in the case of Egypt in 1982 and in 1998. It is thus possible to compare the extent to which each of these expenditures was affected when the bulge disappeared. Below, we will go over the main budget items in turn, and look at how much they bore the brunt of adjustment, in order to analyze the impact of adjustment on the economy and society.

6.1 Public investment and the growth process

One of the items that was most affected was public investment, which collapsed in most countries – from about 14% to 15% of GDP in our 3 types of countries during 1980s and early 1990s, to 6% to 7% in each of the regions (Table 7). The public investment collapse was most marked in the GCC, Algeria, Syria, Jordan, and Tunisia. Over time, this lower investment in infrastructure, schools, and other state assets would have an increasingly negative effect on economic growth, especially in the marginalized regions that were allowed to fall behind – and from where most of the 2011 uprisings started (as in Sidi-Bouzid in Tunisia or Deraa and Deir al-Zorr in Syria).

MENA countries had invested as high a proportion of national output as other LDCs in the 1960s-1980s. Between 1970 to the1990s, investment rates in the three types of countries were between 25% and 27% percent of GDP, below East Asian record levels, but more than in any other developing region. Nearly half of this investment was made by the public sectors of the region. Much of this investment went to public enterprises, and initially, they reaped good returns in terms of growth. In some countries however, these investment were of low return, especially when combined with import substitution policies. Large and inefficient investments were mainly the problem of oil rich countries such as Algeria throughout, Saudi Arabia in the 80s, Iran in the 1970s and 1980s, as well as in Syria and Iraq throughout the period. In Egypt too, large investments in heavy industries were not sustainable and did not produce good returns. By the end of the 1990s, public investment had collapsed to about 5% of GDP in the RPLR countries. Private investment, however, only partly filled the gap (Table 8). It rose only slightly from its historical levels in RPLR countries, such as the reforming Morocco, Tunisia, and Jordan, and in Lebanon after the end of its civil war.[11] But private investment remained low in Egypt at between 10 to 15% of GDP (and capital flight remained high, at between 5 and 10% of GDP, reflecting high political risk). It remained low in RALR countries, and declined in Syria, Yemen, and Algeria.[12]FDI too remained relatively low.

Investment and growth. The central question of why the Arab region underperformed, given what looked on paper to be impeccable market reforms, has been debated for years.

[11] In several countries, and especially Morocco and Iran, much of what is counted as private sector is investment by public enterprises.

[12] The reforms have led to a situation where the return on investment, in terms of growth, was somewhat improved (Noland and Pack 2007). Other factors also improved and contributed to growth and, in particular, higher levels of skills. But there is a also a recognition that its efficiency was being weighed down by rising weaknesses in infrastructure, related to reduced spending by governments.

Economists have tended to argue that the market reforms did not go far enough (Noland and Pack 2007; World Bank 2009). A slightly different view is that reforms appear better on paper than they are in reality, and that as markets were liberalized, rules that govern the market were applied in a discretionary manner, in a way that benefits "networks of privilege" (Heydemann 2004) – firms with personal and social ties with the political elites. In this way, the distance between the de jure and the de facto rules has tended to increase (Pritchett 2012). This seems to have hurt growth: recently, the World Bank has estimated that, based on the experience of countries that had, on paper, done as much to reform their economies as the MENA countries, growth in the MENA region should have been 1 to 2% points *higher* than its actual growth rate (World Bank 2010). The main culprit, then, for this weak performance must be seen as political, in the strategy of "economic reforms first, and political reforms later," which led to an inefficient form of capitalism to develop. Political scientists working on the region have been arguing that economies in the region had become dominated by networks of privilege (Heydemann 2004) and crony capitalists (Sadowski 1991, Owen 2006) with myopic short-term interests that have stifled competition and innovation. The way in which the private sector evolved into a highly dualistic structure, with a few large firms on top, and a large informal economy, and with very few dynamic firms in the middle, supports this view. Recent research seems to confirm that the system of political favoritism and barriers to entry that have emerged in the liberal era have reduced competition and pushed much of private capital to the few large firms that could be trusted by politicians, rather than towards firms that could use capital more efficiently (see Keefer, Diwan and Schiffbauer 2014 on Egypt; Rijkeret et al. 2013 on Tunisia). Privileges were partly of a fiscal nature – in the form of preferential access to state procurement, cheap privatization and land sales, tax benefits – and partly related to the application of regulation in a differential way.

The patterns of growth that emerged after most of the countries of the region undertook structural adjustment programs reflect the low dynamism of their private sector. For the region as a whole, growth was moderate and driven by modest improvements in the efficiency of this investment and by rising labor force participation (outside of the GCC and of Syria). As a result, manufacturing remained low, and exports only rose moderately. The low dynamism of the private sector could have also been due to other factors, including the effects of the Dutch Disease pushing investment into the non-tradable sectors, or to political risk deterring private investment. Moreover, the international economic context established another layer of constraints. Since the 1980s, when Middle Eastern countries began to pursue export-led industrialization, the global economy has become increasingly competitive. Capable states and constructive business-government relations had facilitated an economic takeoff in the East Asian countries beginning in the 1960s, but a propitious external environment and available export markets at that time, and in the context of the Cold War, ensured that countries such as South Korea and Taiwan had ample outlets for their manufactured exports (Haggard et al. 1990; Stallings 1990).

While in all countries, production is now definitely private sector driven, there are important questions about the sustainability of recent growth, which has been mainly driven by non-tradables rather than exports, and with little movement up the quality ladder. Indeed, while exports increased in most countries, performance was generally mixed. Some countries made big progress, like Morocco and Tunisia, while others did not, like Egypt. In the RALR and RALP countries, a very small share of exports is constituted of manufacturing goods.[13]In sum, the withdrawal of the state from the production sphere did not manage to boost the private sector as a new engine for growth, at least outside the GCC. Moreover, the new

[13]Nevertheless, Saudi Arabia's expansion of manufacturing export, while a small share of its overall exports, is remarkable. With over US$20 billion in sales of manufacturing goods, it tops all other countries of the region, but much of this is due to the massive energy subsidies that the industry receives, in addition to cheap labor from migration.

production structures were not favorable from a fiscal perspective: crony firms devour subsidies of various sorts, and the remaining large informal sector does not pay taxes.

6.2 The civil service and the labor market

The civil sector wage bill was squeezed too, but typically much less than public investment. Averaging over country types, the reduction in the wage bill was highest in the RALP countries (from 15.2 to 8.7%), followed by the RALR (from 10.7 to 7.5% GDP) and then by the RPLR group (9.7 to 5.9% GDP) – see Table 9. Compared to the average developing country, where the wage bill stands at about 10% GDP, the wage bill in the RALR and RPLA countries still stands below these global averages in 2010.

New hiring in the public sector was at least reduced and in most cases frozen, dealing a hard blow to educated entrants to the job market who had traditionally joined the public sector in the past. Due to the inheritance of the past, public sector employment remains high in the region, but in most of the RPLR countries, in the past two decades, the public sector has shrunk (see Table 10). In these countries, the overall wage bill fell faster that public sector employment, resulting in a (still large but) underpaid civil service, which fed petty corruption. The challenge of large and underpaid state sectors is a huge challenge in these countries, and it has negatively affected the ability of the state to deliver basic services to the population (see below). Figure 3 depicts variation in state capacity across political economy types, as measured by the World Bank's indicator of government effectiveness.[14] The variable measures state capacity, or the ability of state authorities and institutions to formulate and execute policies and administer their territories effectively. State capacity, which is increasingly invoked as a sine qua non for successful and sustainable economic development, taps into a variety of state activities, such as defending the national territory, making and enforcing rules and regulations, collecting taxes, and managing the economy. It is apparent in Figure 3 that "capacity" was at relatively good level in the RALP countries relative to their income, but was abysmally low in the RPLR countries.

The return to education in most countries of the RPLR type has not recovered because the private sector demand has mostly been for low-skilled workers (Tzannatos and Diwan 2014). The improved economic growth experienced since the mid-1990s has, however, generated a healthy employment response. The region's labor force grew at the most rapid rate in the world (and so employment "elasticities" were among the highest in the world (see IMF 2013)). So, growth has not been "jobless" as it is often claimed. But the jobs created were low productivity jobs, biased towards the informal sector. There was also not sufficient job creation, and so by 2010, the unemployment rates were large, and especially among the educated youth, and among women (who have traditionally had a preference for public sector jobs). Moreover, labor markets exhibited a rising level of inequality of opportunities given the scarcity of good jobs. The formal private sector remains low everywhere, at about only 10% to 15% of the labor force in Egypt, Yemen and Morocco and even Tunisia, and slightly larger at 22% in Jordan where the formal labor market is less regulated. The formal private sector has however has taken on most of finance, starving the informal sector.

On the other hand, hiring in the state sector has continued unabated in the RALP countries. Indeed, the social contract still rests on the employment of all nationals in the public service, while foreign workers flock into the growing private sector at much lower wages. Over time, the civil administration in these countries grew prodigiously. Kuwait's expanded from 22,000 in 1963 to 146,000 in 1980 and to 392,000 in 2009. Saudi Arabia's grew from 37,000 in 1962, to 312,000 in 1981, and to 827,000 in 2008. All together, of the about 4.2 million Gulf

[14] The variable Government Effectiveness captures "perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies" (Kaufman, Kraay&Mastruzzi 2010).

national workers in the labor force, most work for the public sector – the average for GCC is 70%, ranging from 34% in Bahrain to 75% in Saudi Arabia and to 87% in Qatar (Hodson 2013, Hertog 2012).

Most Gulf state nationals not only work for the state, but the wages they earn tend to be multiples of what is offered in the unregulated private sector labor market - 2 to 4 times in Saudi Arabia (4 for lowest skills), and about 2 times in Bahrain for example (Espinoza et al. 2013). As a result, nearly all nationals that work – and the rates of labor force participation are particularly low – work for the public sector. Current rates of national employment in the private sector in the various GCC countries range from 1% to 4% (in Qatar Kuwait, and the UAE), to about 10 to 15% (in Saudi Arabia, Bahrain, and Oman). In effect, unless the gap between private and public compensation narrows dramatically, nationals are simply not employable in the private sector.

Whenever Gulf States have tried to reduce the pressure for hiring in the public sector, as had happened in the late 1990s at the low point of oil prices, this was met by a rise in youth unemployment. Whenever unemployment coincides with large-scale immigration, political criticism of immigration rises. Replacing foreigners with unemployed locals is no easy matter, however. Because of the wage differentials, job-security, and prestige, locals do not want to take the kinds of jobs that many foreigners accept. Every country in the Gulf has embarked on a "nationalization" campaign, aimed at reducing employment of immigrants and reducing national unemployment. This has been most successful in the public sector, which has over time become much more "nationalized." Countries have at times also tried to impose restrictions on private-sector hiring, as when Saudi Arabia attempted to restrict jewelry retail trade (formerly dominated by Yemenis) to Saudis. There have been limited successes here. The private sector does not like these policies, and it can resist them by slowing down implementation. Many locals prefer to remain unemployed, hoping for a public-sector job down the line (Yousef 2005). Despite all the efforts, only in Saudi Arabia, which has recently implemented a quota system, has the percentage of the labor force that is foreign somewhat declined, and even there foreigners still fill more than one-half of all jobs.

As education levels rise, the pressure to employ nationals in the state only intensifies. A good share of the oil revenues has been spent on education in the GCC, with the goal of making national labor more efficient. In recent years, a larger share of budgets has gone into social services as public investment fell. Human development indicators, while still below what would be suggested by these countries' high income, have improved considerably since the 1980s, and in 2010, Qatar, Bahrain, Saudi Arabia, and the UAE ranked among the top 30 achievers globally on the HDI. The question remains as to how this increase in skills will benefit the national economies as long as national labor remains shut off from the private sector.

A related and graver political challenge is the rise of educated unemployment. Depending on the source one consults, unemployment in Gulf States can vary between 5% and 12%, with higher figures reported for the educated youth. It may well be that youth unemployment in the LPRA is as bad as that in the RALR countries. While the problems are very different – no jobs in the RALR, and plenty of jobs in the RALP but all for foreigners – the effect is the same. As long as there are no mechanisms to motivate nationals to work in the private sector, the pressure on the budget will only increase since oil revenues cannot possibly increase as fast as the growth of the labor force (now at about 4% a year). Because the new entrants to the labor market are increasingly more educated, they also hold higher expectations. For example, ¾ of the current cohort of students in Saudi Arabia are in university. The limits of the patronage-driven model is most keenly felt by young Saudis, whose "waithood" period

keeps getting longer as they need to queue for public sector jobs, housing, or loans in support of SME development (Hertog 2013).

In comparison, the diversification and employment challenges are even more acute in the RALR countries. The RALP countries problem is essentially a political problem: the jobs exist; the challenge is simply about convincing the local private sector and labor to work together. In the RALR countries however, the jobs do not exist, the private sector is extremely weak and dominated by a narrow range of cronies and a few dysfunctional public enterprises. As a result, not only is unemployment high, but as we have seen above, the economies have increasingly become *less* diversified over time. Increasingly, and despite their large endowment of oil and labor, the economies of the RALR countries are becoming economies dominated by three things: oil, some public employment for the lucky ones, especially in the security forces, and a huge unproductive informal sector for all the rest. If the RALP countries do not manage to find a more productive development model, the RALR experience shows the risks ahead, when their population size starts catching up with their oil revenues.

The employment problem may now be the most politically volatile economic issue facing the region. The root causes for high unemployment vary. In the RPLA countries, there has been much debate on the cause for the high unemployment rates, especially among educated youth. One line of thought has been that much of the problem is due to the unemployed themselves, their high reservation wages, and their willingness to queue until public sector jobs open up (e.g., see Assaad, 2013). There is certainly some truth to this in the richer GCC countries, but the evidence for such phenomena in the poorer countries is scant. The more convincing argument in those countries is that the lack of good jobs is due to demand for job considerations, which is connected to the low dynamism of the private sector (Diwan and Tzannatos 2014). In the GCC, however, job creation occurred, but the system of patronage has created barriers for nationals to enter the new private sector jobs, which are typically tailored for low jobs and often for low productivity as well.

6.3 Social Service and social mobility

The first few decades after independence witnessed major gains in quality of life indicators. For example, in 1960, the infant mortality rate (IMR) was slightly higher in Arab states (154 deaths per 1,000 births) than in sub-Saharan Africa (151/1,000). In 2011, the IMR in the Arab world was 30 and in sub-Saharan Africa was 86 per 1,000 births. Thus, over a 45-year period, the Arab states maintained the highest annualized rate of IMR reduction (3.6 percent), three times faster than in Africa (1.2 percent), one-third faster than in Asia (2.7 percent) and slightly faster than in Latin America (3.4 percent). In addition, poverty rates declined significantly more in the Middle East than other regions in the Global South (Kuhn 2013).

As the fiscal bulge shrank, government spending on health and education has been the least affected, except in the RALR countries where it fell precipitously from 6.5% to 3.8%, an extraordinarily low level, which mainly reflects low levels of spending on this category in Syria. In the other two regions, it fell from 7-9% to about 6% of GDP, but more recently, it rose again in the GCC, reaching high levels of 12% GDP in Saudi Arabia for example.

The freeze in budgets going to health and education led to less progress in human development and to the worsening of the quality of services, especially those going to the poor who could not afford to purchase these services in the burgeoning private sector. A recent UNDP study confirms this in dramatic ways. The study looks at the evolution of the Human Development Index (HDI) and measures the performance of the health and education systems in all regions during 1990-2010 in comparison to its evolution in the period 1970-2010. A slowdown can be observed in all countries, but it is particularly marked in the region. After taking off in the 1970s, the rate of increase in the HDI index in the Arab region

has slowed down markedly. Early improvements were, like elsewhere, easier to achieve, coming from a low base, and they were also boosted by the high expenditures on social sectors in the early period characterized by the rise of the state, and the first oil boom. Progress has become more constrained in the recent past, partly because incremental advancement is harder, but also in large part because of the fiscal constraints.

Access to public health and education are the main avenues that allow the poor to escape from their poverty trap, over generational change. There is evidence that poverty reduction, which was robust during the oil-boom period of the 1970s and 1980s, has essentially stagnated since the early 1990s, and many millions of residents of the region have become unable to progress socially in the way previous generations have through hard work and education, and seem to have become stuck in a poverty trap, due to the roll-back of state services.

Apart from the persistence of poverty, a possible rise in inequalities has also been cited as a major factor behind the Arab uprisings. But if the poverty data are opaque, the data on distribution are murkier still. As a result, and unlike the case for poverty figures, the evidence for this proposition is scanty at best, and some of the evidence is contradictory. First, consumption inequality tends to be low in the region compared to more unequal regions of the world, such as Latin America or Africa, as a result of the "socialism" of the past. There are some notable variations, with inequality highest in Morocco, Jordan, Tunisia, and Yemen (where Gini coefficients are around 40%), and lowest in Egypt and Syria (with Gini coefficients are around 30%). These data suggest that inequality rose everywhere after the reforms of the 1990s, from a low base. It may well be that people benchmark relative to the past, and not to global experiences, and so rising inequality may explain the frustrations underlying the uprisings (Bibi and Nabli 2010). But more likely, the figures we have do not reflect reality well. There are several reasons to doubt that the measures we have are adequate: they are based on consumption rather than income; lack the rich (who rarely fill consumption surveys); and lack geographical distribution. One distinct possibility is that while inequality between the poor and the middle class has not varied much, the inequality between the middle class and the rich seems to have increased a lot after the 1990s (ESCWA 2013). Indeed, two groups must have profited most from the liberal reforms. The first group constitutes perhaps the top 10% of the population that have a member of their household employed in the formal labor markets. The second group is the 1% who greatly enriched themselves thanks to their political connections. The work of Piketty and associates has shown that these groups control as much as 40% of income, and a larger share of wealth in the US – the figure in the MENA region may have grown even larger (Facundo and Piketty 2014).

6.4 Subsidies and the policy of co-optation

The other item that was slashed most during the adjustment episode, besides public investment, is subsidies for consumer goods. In the 1980s, these often were often in the form of food subsidies and went predominantly to the poor. This line item is measured imprecisely in fiscal accounts, as it is often financed off budget. Nevertheless, our imprecise figures in Table 7 illustrate the magnitude of the decline in subsidies, especially in the RPLR countries, where they were cut from a height of about 9.7% to about 1.1% of GDP. Early attempts to cut down these subsidies had led to food riots from Casablanca to Cairo, and governments had to resort to "stealth" reforms to reduce these subsidies over time (Sadowski 1998).[15]In the RALR countries, subsidies started at higher levels and remained high, as this was one of the main ways in which these oil producers transfer some oil income to their citizens.

[15] For example, rather than increase the price of the subsidized *baladi* bread, the authorities in Egypt reduced it size.

With the increase in energy prices in the 2000s and the attempt by many governments to lure the rich and middle class to continue supporting their weakened hold on power, subsidizing energy and petroleum products rose in the 2000s, further shrinking an already squeezed fiscal space. Energy subsidies grew over time and by 2011, they were much higher in the Middle East than in any other region of the world. In absolute terms, about 50% of global energy subsidies are disbursed in the MENA region. These subsidies represented about 8.5% percent of regional GDP and 22% of total government revenues during around 2010, much larger than in other developing regions, keeping in mind that subsides tend to be negligible in the advanced economies. Within the region, levels of subsidies vary, but 12 of the 20 countries in the region have subsidies above 5% of GDP. About half of all subsidies in the Middle East go to petroleum products, followed by electricity (IMF 2013 report).

Government expenditures on these subsidies have gone up even more in recent years together with energy prices. In many countries, they now represent an expense several times higher than total spending on health or on education.[16] This phenomenon is not restricted to oil exporters. For example, in 2011, energy subsidies represented 41% of government revenues in Egypt, 24% in Yemen, 22% in Jordan and 19% in Lebanon, in contrast to "only" 10% in Kuwait, 15% in the UAE and 18% in Saudi Arabia. Among oil producers, Algeria and Iran have particularly large energy subsidies – 27% and 50% of their respective revenues – even *after* the famous Iranian subsidy reforms (Salehi-Isfahani 2013). It is well known that such subsidies are very regressive, as oil products tend to be consumed in much larger quantities by richer people. For example, a study in Egypt shows that in the case of oil petroleum subsidies, 46% of the benefits accrued to the top quintile in 2008 (Abouleinem, Al-Tathy, and Kheir-el-Din 2009). Once in place, it is almost impossible to reduce or eliminate subsidies because of the threat of political backlash by key constituents.

Some of the energy subsidies go to support the industrial sector, especially in the GCC where these expenditures are enormous. Saudi Arabia, but also all the GCC countries, have sought to give a comparative advantage to their industries by heavily subsidizing energy costs. This strategy has elicited a strong supply response. Manufacturing activities have expanded rapidly and so have exports, helping the economies of the GCC diversify somewhat. A large proportion of this has gone into the petrochemical and high energy intensive sectors. In 2011, manufacturing as a share of non-oil GDP stood at 22% in Saudi Arabia and Qatar, 19% in Bahrain, and 13% in UAE, in all cases well above these ratios in the 1990s. And while most exports are dominated by oil and gas (which accounts for over 90% of exports in Saudi Arabia, Qatar, and Kuwait, and 75% in Bahrain and Oman), non-oil exports have been growing too. But here too, 50% to 60% of non-oil exports are constituted by petrochemicals and high energy products. These are heavily subsidized sectors, and so performance is artificially boosted.[17]

To evaluate whether energy subsidies are a good thing, we should look at the cost of the strategy. There are clearly some benefits to this strategy - it has encouraged technologically advanced sectors to develop and grow, and there should be positive externality in terms of technological transfers and skill formation. Moreover, FDI has been attracted in, which typically boosts technological transfers and the acquisition of skills. Energy is actually sold above its extraction cost, so at least on paper, the governments are making a profit. But one should be considering opportunity cost, as this energy could be sold internationally. By this measure, the cost of these subsidies is huge: in 2011, they were estimated by the IMF (see Espinoza et al. 2013), at international prices, to stand at $44 billion for Saudi Arabia, $8

[16] For example, spending on energy subsidies exceeds social expenditures by two to three times in Egypt and Tunisia.

[17] Other exports include agro industries, base metals, electrical machinery, and services, especially transport and tourism.

billion for Kuwait, $18 billion for the UAE, and $4 billion for Qatar.[18] But the real opportunity cost could actually be lower than this, on two accounts: much of the energy sold is gas, a byproduct of oil extraction, which is hard to export and would be burned if there was no local demand (for e.g., in Saudi Arabia); second, these countries are bound by export quotas, so the oil/gas would have to stay underground if not used locally. While these arguments seem to make sense, and suggest that the costs of the subsidies are less than suggested by the IMF, three trends remain worrisome. First, the energy used by unit of output is very large, with large environmental costs. Second, domestic demand for energy, boosted by low prices, has been growing so fast so as to threaten to reduce these countries' ability to export oil, given current capacity, particularly for Saudi Arabia (and Iran). Third, and perhaps most important, these sectors tend to be heavily energy, and thus capital, intensive, so they create few jobs, and some of these jobs require skills that are not available in the countries, so they tend to be occupied by foreign workers.

This last point embodies the main problem with private sector development in the GCC. The incentives it faces – cheap labor imports, and cheap energy – push it to develop a dualistic industrial structure that is either very capital intensive (in sectors that depend on cheap energy), and very labor intensive (in sectors that depend on cheap labor imports). Thus, these industries do not create the types of jobs that will be attractive to educated and high wage GCC nationals. Private sector development has mostly benefitted entrepreneurs, who have become richer, but it has so far not positively affected the GCC middle class.

6.5 Security expenditures and the rise in repression

The level of spending on security matters (Table 11) is much harder to measure. Typically, military expenditure was also cut, but remained very high. In the RALP countries, military expenditures were reduced from an extraordinary average of 10.4% GDP to a still high level of 6.2% (the average globally is less than 2%, Elbadawi and Keefer 2014). These high levels are partly due to the strategic challenge of defending oil installations, ensuring that the nearly 12 million of expatriate labor in the GCC do not constitute a security threat, and, importantly, hiring in the security sector has traditionally been an important form of patronage as well. One defining issue that hurt the legitimacy of Gulf rulers was their inability to face Iraq's aggression without the support of the US army. In Saudi Arabia, military spending had typically eaten away a large part of state budgets, oscillating around 30% of government spending.[19]The Kuwait war made it all too clear that the mighty army built with hundreds of billions of dollars was a more efficient tool of patronage than of national defense, a proposition that average Saudis find humiliating.

In the RALR and RPLR countries, spending on defense was cut, but spending on internal security and police rose, as repression increased, in large part to quell the rise in protests and social demands. In several countries moreover, the military went off budget to protect their interest. In Egypt for example, it is estimated that the military economy ranges between 10 and 30% of GDP, with the army operating its own factories, housing schemes, and consumer goods distribution (Keefer and Al-Badawi 2014).

Repression was certainly a core component of any account of authoritarian persistence, especially in the RALR countries (Iraq, Algeria, Sudan), but also increasingly after 9/11 in the RPLA countries (Egypt and Tunisia included). The threat of harassment, persecution,

[18] These amounts represent the quantity sold to the private sector, times the difference between international price, and the price energy was sold at to local producers.

[19]In addition to patronage, the emphasis on military development reflected some unique geographical challenges for Saudi Arabia, such as a widely dispersed population and infrastructure, long coastlines, and close proximity to highly-militarized regional rivals such as Iraq and Iran. Moreover, the military build-up heavily relied on the purchase of United States military technology. Saudi Arabia reciprocated such deals with promises to keep oil prices low in the late 1970s and 1980s.

imprisonment, torture and death are powerful disincentives for anti-regime activism. It is virtually a truism that repression is never a sufficient or even the most effective tool of political control. The literature on persistent authoritarianism in the Middle East has described in detail how (and, in some cases, why) different regimes chose to respond with distinct mixes of co-optation and repression to maintain their control. Autocrats aimed to maximize their dwindling assets by dividing citizens into groups that benefited from co-optation while others were subject to repression and neglect. In countries that lacked high per capita oil wealth, authoritarian rulers sought to strengthen their coalitions by co-opting the middle classes, which were largely composed of public sector employees and some formal sector workers in Middle Eastern countries. The literature on authoritarian durability is voluminous.[20] External support for authoritarian rule is a distinctive feature of the region and, therefore, is a key component of any explanation for the persistence of authoritarianism in the Middle East in comparison with other regions (El Badawi and Makdisi 2007; Bellin 2004; Levitsky and Way 2010). External support provided rents in the form of aid and military support and helped to fuel the militarization of the region, which in turn facilitated state repression of opposition groups.

One big idea in the literature on authoritarianism in the Middle East is that autocrats use a mix of repression and co-optation to stay in power (e.g., Bellin 2004, Posuney and Angrist 2005). A few analysts have also explored how the type of regime affects the choice between these two strategies (Ali and Al Badawi 2013, Malik and Auty 2013). In essence, the two strategies available to rich autocrats are: (i) to develop a distributive state, and build clientelist relations to stabilize their rule; and (ii) to use oil rents for the development of a coercive apparatus, turning into what Robert Sprinborg calls "bunker states." Both strategies create space for state autonomy, but also restrict it in differential ways.

The two strategies can and have been used in parallel, but the core idea is that the relative dependence of regime survival on co-optation versus repression depends in part on a cost benefit calculus. When oil per capita is very high, as in RALP countries, regimes will tend to prefer survival strategies that depend more on rentierism than on sheer repression, while if oil per capita is modest, as in the RALR countries, a strategy of repression is preferred. The central intuition for the assertion can be related to the preferred size of ruling coalition in what North et al. (2009) call limited order arrangements: when resources are plentiful, ruling coalitions can afford to be larger, which produces more stable and less violent orders. On the other hand, when resources are more constrained, ruling coalitions will tend to be narrower, and they will trade-off higher payoffs for some amount of insecurity, even if this reduces the size of the economic pie. In this big brush picture, the GCC seems to fit in the first category, while many RALR countries, including Iraq under Saddam, Assad's Syria, as well as Libya and Algeria, fit under the second.

Figure 4 depicts country scores on the Cingranelli and Richards (1999) Physical Integrity Rights Index, which measures physical repression of populations at the country level. This additive index is constructed from the Torture, Extrajudicial Killing, Political Imprisonment, and Disappearance Indicators ranging from 0 (no government respect for these four rights) to 8 (full government respect for these four rights). It can be readily seen that repression was much higher in the RALR countries compared to regional averages, and lower in the RALP countries, as suggested by the discussion above. This striking empirical evidence provides some confidence that our country classification has analytical teeth. Repression has important effects on the economy and on society, which helps in understanding why the development paths followed by the two types of countries have ended up being so different.

[20]For reviews of this literature, see Posusney and Angrist (2005) and Schlumberger (2007).

Beyond the rather sordid cost-benefit calculus, regime types are also determined by history and geography. There are several historical differences between the two groups that are salient. The emergence of the modern Gulf States — generally coinciding with the twilight of colonial empires worldwide — also coincides with the discovery of oil reserves in the Gulf. The initial development of an oil production industry at this nascent stage of statehood allowed for old structures of (patrimonial/monarchical) governance in the Gulf to not only endure, but prosper -- a twinship continuing through the present. The necessary development of a centralized extraction infrastructure fits neatly into the type of clan-based consolidated patrimonial rule that developed since the 18th century in Arabia (Luciani et al. 2012). Oil, in other words, "underpinned a system of interlocking interests, privileges, and monopolies" already in place prior to its discovery (Owen 2008). On the other hand, the republican RALP countries were borne out of more violent political processes that put at the helm groups that espoused radical departures from the past – embodied for example in Baath ideology in Iraq and Syria, Islamism in Iran and Sudan after 1980s, and socialism in Algeria. In these countries, oil has supported a more benign form of autocratic rule in a first phase, within a modernist nationalistic phase of fast development and industrialization. The second more violent and repressive form emerged later, especially after the industrialization drives of the 1960s and 70s ended up in failures, which coupled with the humiliating defeat of 1967 for the front-line states, put into question the core legitimacy of these regimes.[21] Oil allowed these states to finance large armies and security forces, and also to remain somewhat independent of foreign patrons (Posuney and Angrist 2005).[22]

6.6 The evolution of revenues and the cyclicality of expenditures

A classical claim is that there is no taxation without representation. Tax rates have been relatively low, particularly in the countries with large hydrocarbon reserves. But as shown by Waterbury (Waterbury 1997), most MENA countries are taxed at fairly high levels. One would expect that efforts to collect revenue would rise when the fiscal constraint becomes more binding. But the evidence, in Table 12, suggests that with the exception of Syria, Jordan, and Lebanon, revenues actually decreased after the reforms of the 1990s were implemented. This is surprising and attests to effects of the political re-orientation of the state towards the corporate sector, where taxes were typically cut. For example, Egypt instituted a flat corporate tax rate of 20% in the late 1990s.

As fiscal regimes seem to have become more pro-rich over time, it is interesting to ascertain whether the role of direct taxes have fallen relative to indirect taxes, which tend to be more regressive. Indirect taxes in the form of VAT systems did become a more important component of tax revenue in much of the region after the reforms of the 1990s, and they are inherently regressive because they are applied to consumers across the board, regardless of income levels (Imam and Jacobs 2007). However, at the same time, custom taxes fell as trade was liberalized. On a net basis, our computations in Table 13 suggest that the share of direct taxes in total tax revenues did not fall, and actually rose marginally. A proper evaluation of

[21] History also points to a more geographically-based explanations of the differences between the two groups. In addition to benefitting from relatively small labor populations, the GCC states where notably only lightly incorporated into both Ottoman and European empires, as compared to many others in the MENA region. Several analyses correlate the legacy of colonial-era extraction economies with the weakness of state institutions to develop post-independence (Acemogly, Johnson, and Robinson 2006). Iraq and Algeria were subjected to such extraction. The legacy of such colonial records, and Ottoman history in Iraq through the early 20th century, may partly account for the relative slowness of stable state institutions to develop, as compared to the largely un-colonized Gulf region. Moreover, for some states the characteristics that make them vulnerable to violence are exactly what led colonials to construct them as they are: Iran, Iraq, Syria, Yemen, and Sudan are all examples of states where a strategy of divide and rule carved states that included unhappy minorities and disputed borders.

[22] This independence is an important difference with other countries, such as Jordan and Egypt, which received large external rents, not from oil, but from foreign donors, as their dependence on donors restricted the extent of repression they could engage in.

the incidence of tax regimes is not available, however; a more detailed incidence analysis will be needed before concluding on this core.

The Cyclicality of Expenditures. The relatively large impact of oil in the region engenders important implications related to its price volatility. The boom of the late 1970s, followed by an 18 years bust, and again by a 14 years boom is one aspect of this. This has led to the enormous challenges that Karen Chaudhry has called the "discontinuous construction" of economic (and political) institutions (Chaudhry 1994). There is also a second challenge, related to the shorter term price volatility, which has made government income hard to predict from year to year – recall for example that oil prices collapse to around $20 during the global crisis of 2008 before coming back to the $80 to $100 level.

The long oil cycle had created difficulties for oil and non-oil countries alike, as described in the first part of the paper. The initial gush of revenues had taken the countries unprepared, and while expenditures were increased relatively fast, it was much harder to adjust for the downside. Government also increased the size of their bureaucracies and of their social programs. When the bust came, investment projects were sharply curtailed, but it was much harder to cut subsidies, social programs, or to reduce state employment.

Saudi Arabia's outsized responsibility to OPEC, as its "swing producer," has made its challenge to stabilize expenditures around a highly volatile income stream more challenging than for most of the oil economies. In the early 1980s, when revenues collapsed, investments were deeply cut after 1985, but King Abdallah refused to touch social programs. Indeed, state employment kept growing, since this was by then perceived to be an entitlement among educated Saudis. The state also declined to turn to taxation as a means to offset the large government welfare costs (Auty 2001). Saudi Arabia reduced its expenditures by only half the amount of revenue fall in the early 1980s. A second adjustment was undertaken in the 1990s, at the end of the Gulf war. As a result, Saudi Arabia had large fiscal deficits for 18 years in a row, resulting in a ballooning debt (mostly domestic). It was only by the late 1990s, when state debts reached dangerously high levels (at over $200 billion) that the Saudi ruling elite decided to move beyond the model of public sector jobs for all. This was a few years before the second oil boom. Saudi Arabia was able to run a surplus for a few years, but then came the Arab uprisings of 2011-12, and there was an irresistible push to get back to the old policies of patronage, which quickly reversed the hard gains achieved by the reforms.

During the second oil boom, most GCC governments expanded expenditures, but unlike in the first boom infrastructure spending was more subdued. Instead, spending on social programs and salaries rose. As a result, government spending, especially Saudi Arabia's, has now become increasingly concentrated on wages, education and health, while public investment in infrastructure has decreased in relative terms. The budget has become more inflexible than in the past. In most countries, the share of the budget going to recurrent expenditures (as opposed to investment) has risen to around 60% to 80% of the budget, with Saudi Arabia at the lower end because of a recent boost in public investment (Hodson, p.113).

The GCC regimes, and especially Saudi Arabia, have reacted to the Arab uprisings with a dramatic rise in patronage commitments. In Saudi Arabia, the cost of the package announced in February and March 2011 to mollify popular grievances – which included employment, housing, and welfare measures – was calculated at US$130 billion. In 2012, nearly 300,000 young Saudis were hired in the public sector – as much as during the previous decade.[23] At the same time, policies of open migration have not been questioned, in an attempt to please the private sector, making it harder to employ Saudis in this sector. The return to the practices

[23]But sufficiently to absorb the 400, 000 Saudis that enter the labor market *every* year.

of the 1970s, but on a much grander scale, seems to mark, for now, a rollback of the reforms of the last decade to confer more autonomy to Saudi businesses and citizens (Hertog 2013). Similarly, public sector salaries were raised by 70% in the UAE. At the same time, the Saudi government has over-reached financially, as it now has quadrupled its expenditure relative to the early 2000s, and needs oil prices to be around US$90 to keep its fiscal accounts balanced. The state is far from broke. But with current policies being sustainable – the day of reckoning simply depends on the price of oil.

Nevertheless, the good years have allowed all GCC countries to set funds aside for the rainy day. Assets accumulated by the sovereign wealth funds (SWFs) of GCC countries as a whole amount to more than US$1.8 trillion, equivalent to 34% of assets accumulated by SWFs. The UAE has the highest proportion of these funds at about $820 million. Moreover, their ownership of public enterprises, which can be privatized over time, is also very large – Saudi Arabia alone is said to have domestic assets valued at over US$1 trillion. This means that, together with its sovereign fund, reserves could sustain the same level of spending as today, on a price of US$50/barrel, for the next ten years, before being forced into adjusting its expenditures.

The costs of macro-instability, both during short and long cycles, are also high for the private sector. To get a sense of magnitude, it can be estimated that the standard deviation (SD) of growth in the GCC is very high – it was about 7% in the period 1976-1990, falling to 4% during 1990-2010. In comparison, it is only 2% in the OECD. This represents an important cost for businesses, especially if they are liquidity constrained (i.e., unable to smooth out their income flows). Decisions about investment become harder, and in the presence of irreversibilities, investment falls. The effect of instability in the GCC is analyzed by Espinoza et al. (2013), who find that a 1% increase in volatility reduces growth by 0.3%.

In the GCC, monetary policy cannot play a role because the exchange rate is pegged to the dollar. But fiscal policy is powerful in the GCC because the private sector is so connected to government spending – investment projects become procurement and wages become demand. Espinoza et al. estimate fiscal multipliers of 0.3% for recurrent expenditures, and as much as .6% for investment expenditures. These multipliers have been falling slowly over time as the private sector becomes slowly less dependent on government expenditures (Hertog 2010a). They also show that Saudi Arabia and Oman have been quite successful at counter-cyclical fiscal policies, while the other countries have not. Saudi Arabia, for example, not only ran a fiscal deficit for 18 years in a row when oil prices were low as described above, but more recently, it has run a budget surplus for 9 years in a row (until the global crisis of 2008) when oil prices were high.

In other countries of the RPLR and RALR, budgets tend to be much tighter as governments are under great pressure to deliver, since typically repression can only go so far. As a result, these countries do not accumulate reserves in good time and tend to live “hand to month” – Algeria is a partial exception, having accumulated about US$200 billion of reserves by 2014. The pressure to spend has been unrelenting since oil prices have risen in the past few years – even in Iran, the elimination of energy subsidies ended up consuming a larger share of the budget! Another example is the massive build up of the civil service in Iraq, even as no wealth sharing agreement is yet in place in the country to consolidate plans for increased oil extraction.

The RALR countries, however, did not have the deep pockets that the GCC states had, and thus have not been able to avoid policy reforms and smooth shocks over such long durations, let alone find ways to enhance their economic prospects. Moreover, also unlike Saudi Arabia and other countries of the GCC, these countries never saw the development of the private sector as an attractive alternative to state led development, as it threatened regime durability

at its core, given the smaller size of the spoils that could tie it to the regime. As a result, while they were more flexible at imposing top-down changes, their alternatives were severely curtailed. In many of these countries, the state retreated and was replaced by a very narrow form of cronyism, closely associated with the regime, and with rising levels of repression. In some cases, as notoriously illustrated by Iraq's invasion of Kuwait, foreign adventurism was a means to attempt to replenish "strategic rents." In addition, myopic interests connected to the fragility of their autocratic rule explains why these states tended to be the hawks in OPEC, pushing for increased international oil prices, even at the risk of a falling global demand over time.

In Algeria, the attempt to reform after the first oil shock had led to the civil war that still marks the socio-political scene today. Under the guise of the fight against Islamists, army interests have come to dominate a stagnating private sector. In Syria, low oil prices (together with falling reserves) led to a rapid economic adjustment that dramatically reduced state involvement in peripheral regions from which the ongoing revolution emerged. The country's intervention in Lebanon was largely predicated on extracting rents. The economic reforms led to the increased concentration of economic powers among the elite, cousins of the president, and sons of generals. Foreign policy too was dominated by the search for increased strategic rents, from the Gulf, and/or Iran. Russia and Syria carefully avoided becoming accountable to a single foreign patron. Iraq, coming out of the war with Iran with a huge foreign debt and destroyed infrastructure, sought to invade Kuwait as a way to shore its economy, with dramatic consequences for the Iraqi people. Iraq lost most of its oil revenues during its war with Iran when its export facilities at Shatt-el-Arab were bombed, and again when it was under sanctions, and in both cases, the country had to undergo wrenching and socially calamitous adjustment periods.[24] In Sudan and Yemen, the shock was not due to developments regarding the international price of oil, but to security "shocks". In Sudan, the fight over dwindling resources led to the disaster of Darfur, and the pursuit of oil revenues to a deal with the SPLM that led to the division of the country. In Yemen, the fight over newly discovered oil led to a civil war and the forced unification of the country.

7. Policy and Research: Challenges Ahead

We have seen in the paper how fiscal policy has been at the center of the political settlements that has emerged after the 1980s. In the RPLR countries, as regimes across the region moved to the right and entered into coalitions with narrow business elites, fiscal policy became more regressive: public investment took the brunt of the adjustment and has remained low ever since, hurting the growth process; expenditures on wages, health, and education were contained and are too low to secure the type of quality services needed to maintain progress on human indicators; expenditures on energy subsidies and security shot up; and the tax effort was reduced.

As the political settlement in the transitional RPLR countries evolves, one would expect that the interests of the poor and lower middle classes will be rebalanced against those of the rich and the upper middle class. At the heart of such a settlement, fiscal policy will need to be considerably re-arranged. While the precise role of the state will need to be re-imagined, there is no doubt that the modernization of the state and the rehabilitation of public services, especially health, education and social protection, will stand at the center of the new settlement. New governments with broad popular support will be able to redirect expenditures towards social services and away from subsidies that benefit the better-off, and to make tax systems more progressive, while enlarging the tax base. Improving service delivery and fighting petty corruption will require increased public sector wages, which will be complicated by the large size of the civil service. The political and economic challenges

[24]For figures on the costs of the Iran-Iraq war, see Al Nasrawi (2004).

facing these countries are compounded by high popular expectations and problematic legacies of the past. The main economic challenges will be difficult to resolve, even if politics becomes less polarized. How to build a package of measures that reduces expenditures and raises revenues and that commands some minimum level of popular support is a tricky endeavor in the best of circumstances, and it will be very challenging in the current hyper-politicized environment. A more stable political environment will be needed to initiate important reforms.

Thus, the most immediate challenge is economic stabilization in order to avoid an economic and financial meltdown, which would further complicate the political process. The revolutions were experienced as a negative economic shock. Tourism took a hit, capital flight accelerated, exports declined and investment collapsed in Tunisia, Egypt and Yemen. As a result, economic growth declined sharply in 2011 and only stabilized at lower levels in 2012 and 2013. Output collapsed in Libya given the disruption to its oil production (-60 percent). Across the region, unemployment has increased. Syria has been devastated. The human toll in death and suffering is staggering. Millions have been made refugees, in their country and in neighboring countries. Economic production has taken a big hit, and the destruction of assets is already estimated in the tens of billions of dollars. The economies of Lebanon and Jordan have also been negatively affected by regional instability and the influx of refugees.

Initially, governments reacted with expansionary policies to smooth out the downturn, especially in the face of rising social demands and the high expectations generated by the uprisings. Public sector wages, subsidies, and government investment were increased in many countries around the region. By 2013, fiscal deficits in Morocco, Jordan, Tunisia and Lebanon had shot up to between 6% and 7% of GDP. In Egypt, the fiscal deficit ballooned at 12% of GDP and international reserves plummeted. These developments meant that by 2013, governments had no fiscal space to continue with stimulus programs. Expansionary policies were supported mainly by domestic debt levels, and in Egypt, by funding from the GCC.[25] The uprisings occurred in the context of a global economic downturn and the Eurozone crisis, which has restricted the availability of external support. As a result, in Egypt, Jordan, and Tunisia, economic indicators are presently flashing yellow, and macroeconomic crises with sharp currency depreciation and banking crises are possible in the future. IMF programs are being developed in these countries, but the "street" may not allow the passage of minimal reforms programs that can contain deficits to levels that are financeable (let alone sustainable). By the beginning of 2014, it has become clear that economic recovery cannot proceed until political crises are resolved. Indeed, a downward spiral may ensue as polarized politics exacerbate economic difficulties, in turn leading to more fractious politics. These are complicated challenges, technically, politically and administratively. New research needs to focus on how to build programs that not only work, but also have popular appeal.

The policy agenda in the GCC is entirely different, but just as challenging. The growth model that has taken root in the Gulf and which has started to achieve notable successes on the economic front in the past ten years is not sustainable. From a purely economic perspective, the problem facing the GCC states is a problem of riches. In these countries, the development strategies so far have been to first import labor and subsidize industry, and then, over time, educate national labor, employ the first generations of increasingly skilled domestic labor at higher wages in government, improve education and infrastructure over time, and then initiate nationalization programs (i.e., replace foreign labor with domestic labor over time). One needs to think of this strategy as one that spans several generations and allows for social transformations – urbanization, education, socialization – which over time start creating

[25] The Deauville Partnership, an international effort launched by the G8 countries in May 2011, aimed to provide assistance for economic stabilization, promote job creation, good governance and regional integration in the Arab transitioning countries.

cohorts that will populate an economy driven by an efficient private sector. The real issues, then, are on the technical front, involving timing and sequencing; and on the more challenging political front, ensuring that the social contract can gradually evolve to allow for such a transformation. The sustainability problem of the Gulf States is not (yet) how to live in a world without oil, but rather, how to effectively employ a fast growing national labor force. The current strategy of public sector employment will reach its limits sooner or later, given the high rate of growth of the population (now at 2%) and especially of the labor force (now at about 4%), with the difference due to the demographics as well as to increased female participation. Already 40% to 60% of budgets are allocated to wages and social programs. So the real economic constraint is that patronage, the way it is exercised with a growing population, is increasingly unsustainable. What is needed are ways to lower transfers per capita, and in parallel, reduce inefficiencies in the way energy and labor inputs are used up in the economy in order to create a larger pie.

The essential problem is that gradual tools to achieve such as vision have not yet been found. By the 1990s, growth in the native labor force in Saudi Arabia had overwhelmed the government's capacity to employ in a bureaucratic system already plagued by over-employment. The higher wages that government jobs afford discourage many Saudis from pursuing private employment, and for the same reasons the local workforce is not attractive to private employers. The only way to effectively bring national workers into the labor force is to reduce the wage gap between them and migrant workers. National quota systems and occupation bans for foreigners have not succeeded and have created widespread avoidance efforts. Politically, such a transition pits the interests of labor (the rising middle class) and those of the elite in the private sector. To create jobs in the private sector, it will be necessary to also reduce the "rents" that accrue to it, in part in the form of cheap labor. The question becomes: how would this affect the "legitimacy" of a political system that has remained staunchly autocratic? The question is all the more important given the rising income and education levels of the population, which makes it more demanding of freedom and autonomy. Presumably, the private sector would want to have a higher voice as a class if rents fall. But the GCC regimes have reacted to the Arab uprisings with a dramatic rise in patronage commitments, rather than engaging in structural and political reforms. Policies of open migration have not been questioned, but the Saudi government has over-reached financially, as it now has quadrupled its expenditure relative to the early 2000s, and needs oil prices to be around US$90 to keep its fiscal accounts balanced. The state is far from broke. But the current policies are not sustainable – the day of reckoning simply depends on the price of oil. The only question then is how smooth or chaotic this adjustment will be, and whether it could preserve the gains of the past and build towards greater prosperity in the future. Unlike the RALR countries, in the countries of the RALP group a great deal of wealth has been created in the private sector, and a great deal of skills is being invested in the population, and so, there is a greater potential for finding win-win governance accommodations over time between princes, elite entrepreneurs, and the growing domestic middle class. New and more creative ideas need to be part of the policy toolbox, such as cash transfers to the population and income taxation, as means to create incentives to businesses and Saudi labor alike, creating wealth in a private sector-led development model. There is there a rich agenda for useful research.

Prospects in the RALR countries are dimmer. On the one hand, these are countries where the state gets considerable revenues from oil, which can be put to the service of inclusive growth. However, the presence of these revenues also underpins a political settlement, which is not only autocratic, but also highly repressive. When confronted with popular movements, RALR governments have reacted violently. Better fiscal policy there would have to await a more favorable political settlement.

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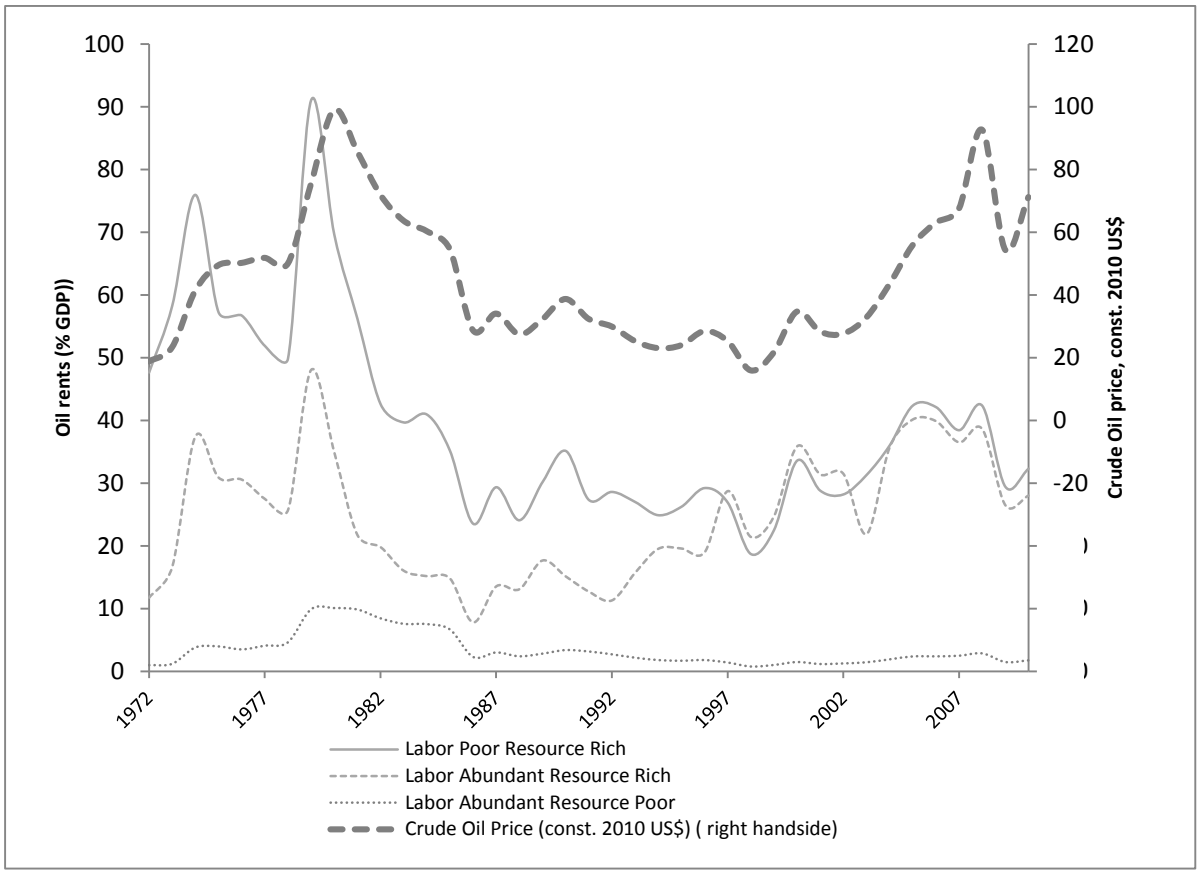
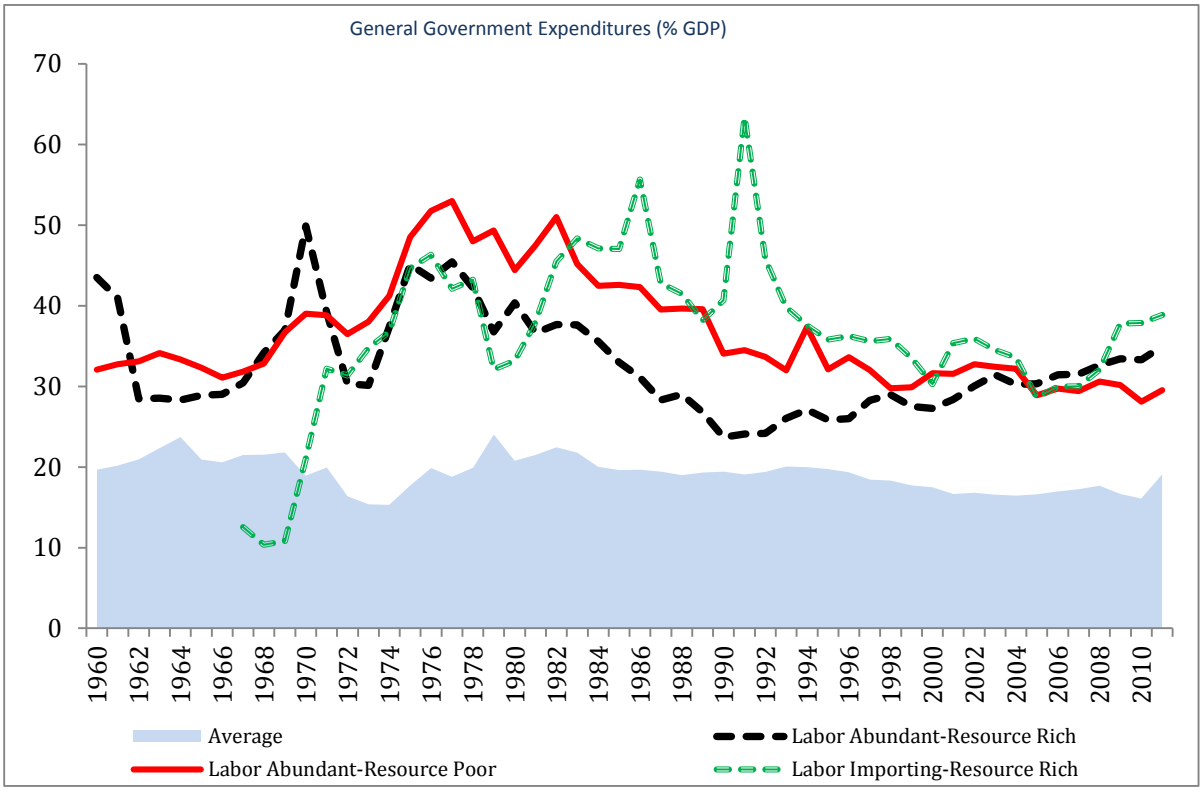
Figure 1: Oil Rent and Oil Prices



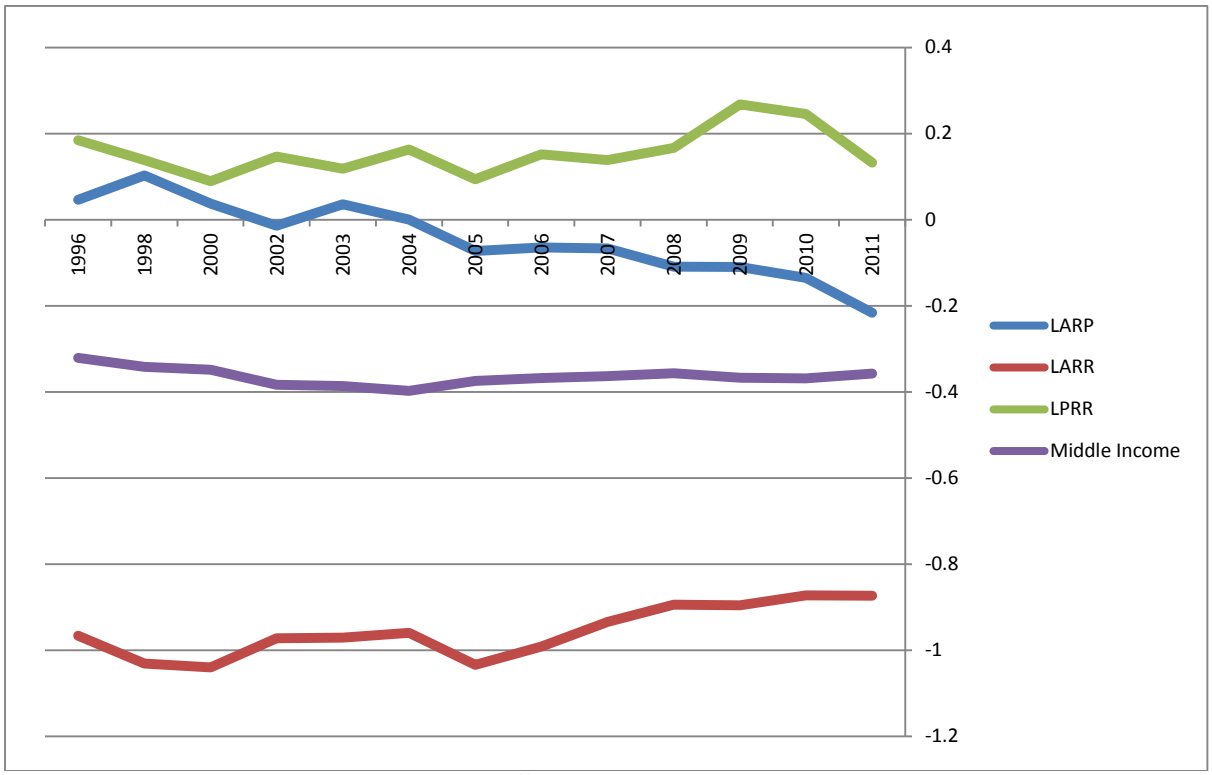
Source: WBI and WEO

Figure 2: The Evolution of the Size of the State



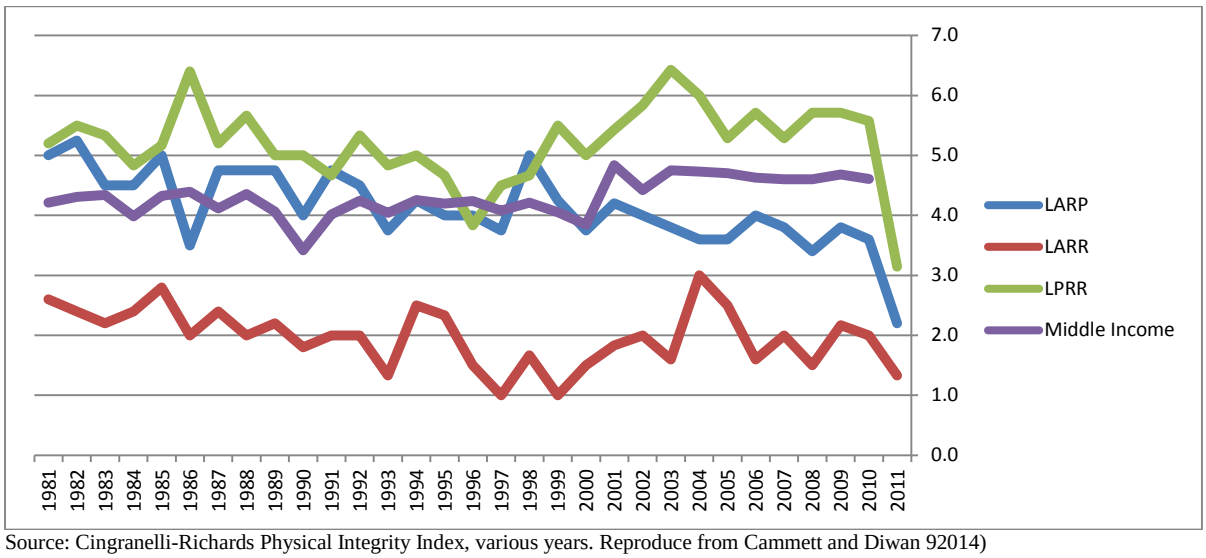
Source: own calculations based on IMF

Figure 3: Government Effectiveness in the Various Sub-Regions (2003-2012)



Source: World Bank Governance Indicators, Government Effectiveness Estimates, various years.

Figure 4: Repression in the Various Sub-Regions (1981-2011)



Source: Cingranelli-Richards Physical Integrity Index, various years. Reproduce from Cammett and Diwan 92014)

Table 1: Country Classification and Oil Rents

2010, current $	GDP (bn)	Population (ml)	Oil rent (bil)	Oil rent per Capita	Oil rent %GDP	GDP per cap.
Resource Abundant Labor Poor	**1231.3**	**49.8**	**438.8**	**9248.5**	**32.3**	**32435.5**
Bahrain	22.9	1.26	4.4	3489.5	19.2	18174.6
Kuwait	124.0	2.74	59.9	21858.4	48.3	45255.5
Libya	74.8	6.36	31.6	4974.9	42.3	11761.0
Oman	57.8	2.78	20.9	7505.7	36.1	20791.4
Qatar	127.0	1.76	18.5	10535.2	14.6	72159.1
Saudi Arabia	526.8	27.40	248.6	9074.8	47.2	19226.3
UAE	298.0	7.51	54.8	7301.2	18.4	39680.4
Resource Abundant Labor Rich	**882.3**	**235.3**	**259.1**	**1015.1**	**28.1**	**3250.9**
Algeria	162.0	37.4	27.4	732.0	16.9	4331.6
Iran	422.6	78.9	99.3	1259.2	23.5	5358.4
Iraq	142.8	33.7	105.1	3118.7	73.6	4237.4
Sudan	64.8	37.2	11.3	303.1	17.4	1741.9
Syria	59.1	22.5	9.6	427.6	16.3	2623.2
Yemen	31.0	25.6	6.4	249.8	20.6	1212.8
Resource Poor Labor Rich	**425.1**	**140.3**	**15.6**	**55.8**	**2.1**	**4032.8**
Egypt	219.0	82.3	13.8	167.7	6.3	2661.6
Jordan	26.4	6.3	0.0	0.1	0.0	4183.8
Lebanon	37.1	4.3		0.0	0.0	8627.9
Morocco	90.8	32.6	0.0	0.1	0.0	2785.3
Tunisia	44.4	10.8	1.8	166.9	4.1	4111.1
Palestine	7.4	4.1	0.0	0.0		1827.2
Turkey	**731.0**	**74.0**	**1.2**	**15.6**	**0.2**	**9878.4**
Overall MENA	**3486.7**	**499.3**	**714.7**	**2067.0**	**20.5**	**15413.2**

Source: WBI

Table 2: Real GDP Per Capita Growth

	1961-1970	1971-1980	1981-1990	1991-2000	2001-2010	SD 1960-2010	Av. 1960-2010
Resource Abundant Labor Poor	**8.22**	**2.56**	**-1.67**	**0.96**	**0.33**	**3.75**	**2.08**
Bahrain	4.20	4.70	-1.49	2.92	-0.94	2.90	1.88
Kuwait	2.50	-3.10	-3.12	-1.58	1.92	2.72	-0.68
Libya			0.20	1.78	2.32	1.10	1.43
Oman	18.62	1.10	4.28	2.64	2.65	7.22	5.86
Qatar					0.84		0.84
Saudi Arabia	4.77	7.86	-5.23	0.55	0.13	4.98	1.62
United Arab Emirates	11.00	2.26	-4.66	-0.56	-4.63	6.47	0.68
Resource Abundant Labor Rich	**3.02**	**3.88**	**-6.47**	**3.98**	**2.06**	**4.41**	**1.30**
Algeria	2.08	3.07	-0.21	-0.18	2.22	1.50	1.40
Iran, Islamic Rep.	8.31	0.86	-1.15	1.99	3.79	3.59	2.76
Iraq	3.20	8.00	-30.00	14.92	-1.53	17.27	-1.08
Sudan	-0.77	0.70	-0.11	3.13	4.39	2.20	1.47
Syria	2.29	6.76	-0.87	2.46	2.37	2.72	2.60
Yemen				1.59	1.14	0.32	1.36
Resource Poor Labor Rich	**3.03**	**6.16**	**0.00**	**2.44**	**2.38**	**2.21**	**2.80**
Egypt	2.82	4.32	3.04	2.50	2.97	0.70	3.13
Jordan		11.74	-1.58	0.99	3.89	5.77	3.76
Lebanon	4.00	7.00	-9.10	4.61	3.93	6.38	2.09
Morocco	2.09	2.65	1.52	1.00	3.80	1.08	2.21
Tunisia	3.21	5.14	1.11	3.10	3.46	1.43	3.20
Palestine		6.10	5.00	2.47	-3.74	4.40	2.46

Source: WBI

Table 3: External Receipts

Regions		1970s	1980s	1990s	2000s	2010
RALP	Oil rent (%GDP)	62.39	35.26	26.50	35.13	32.30
	Net flows of debt (%GDP)	0.00	0.50	3.00	-9.43	5.62
	Total	62.4	35.8	29.5	25.7	37.9
	External Debt (%GDP)	20.94	15.21	29.34	32.73	50.09
RALR	Oil rent (%GDP)	27.71	14.50	27.98	34.12	28.05
	Remittances (%GDP)	3.14	7.99	5.54	2.91	2.04
	Grant (%GDP)	2.68	2.88	1.49	3.75	1.63
	Net flows of debt (%GDP)	3.76	3.31	0.66	-0.09	1.12
	Total	37.3	28.7	35.7	40.7	32.8
	External Debt (%GDP)	12.72	33.20	80.9	44.9	25.0
RPLR	Oil rent (%GDP)	6.76	7.00	2.65	2.84	2.59
	Remittances (%GDP)	8.63	9.96	11.62	13.65	10.22
	Grant (%GDP)	8.63	9.96	11.62	13.65	1.23
	Net flows of debt (%GDP)	7.05	7.19	2.86	2.23	2.17
	Total	31.1	34.1	28.7	32.4	16.2
	External Debt (%GDP)	27.40	68.6	78.9	77.9	65.1

Source: WBI and WEO

Table 4a: ODA to GDP and Net Flows

Countries	Net transfers on external debt (% of GDP)					Grants (% of GDP)				
	1961-1970	1971-1980	1981-1990	1991-2000	2001-2010	1961-1970	1971-1980	1981-1990	1991-2000	2001-2010
Resource Abundant Labor Rich	0.0	4.0	2.6	-0.8	-1.1	0.7	2.7	2.9	1.5	3.7
Algeria	0.0	6.5	-2.3	-4.2	-3.5	2.0	0.8	0.2	0.4	0.3
Iran		-0.1	-0.3	-1.5	0.4	0.1	0.1	0.1	0.2	0.1
Iraq						0.3	0.1	0.1	1.0	16.0
Sudan	0.0	6.3	2.4	0.5	0.5	0.4	2.5	5.1	3.1	4.0
Syria	0.0	3.4	7.8	1.1	-2.5	0.9	9.9	4.9	1.1	0.6
Yemen			5.3	0.2	-0.3			6.9	3.1	1.5
Resource Poor Labor Rich	-0.2	6.0	3.3	-0.4	-0.4	4.9	8.1	5.4	4.9	6.8
Egypt	-0.4	8.7	2.1	-1.9	-1.0	2.2	6.3	4.1	4.1	1.2
Jordan	0.0	5.9	6.1	1.0	-1.0	11.3	22.7	13.4	5.6	5.5
Lebanon			7.0	3.5	1.0			6.0	1.5	1.7
Morocco	0.0	5.6	1.0	-4.0	-1.5	1.3	1.3	1.8	1.7	1.2
Tunisia	-0.6	3.9	0.2	-0.6	0.5	4.8	2.1	1.4	1.1	0.8
Turkey	**-0.2**	**1.6**	**-0.4**	**0.0**	**1.8**	**0.3**	**0.1**	**0.3**	**0.3**	**0.1**
MENA (w/o LPRR)	-0.2	4.6	2.6	-0.5	-0.5	2.2	4.4	3.7	2.9	4.6

Source: WBI

Table 4b: External Debt over GDP

Regions/Countries	1970	1980	1990	2000	2010
Low income	0.0	28.7	63.1	67.1	29.6
Lower middle income	0.7	23.8	51.2	47.0	24.8
Upper middle income	0.0	19.6	26.8	32.1	20.9
Resource Abundant Labor Rich	**0.0**	**24.4**	**64.9**	**58.4**	**25.0**
Algeria	0.0	45.9	45.5	46.4	4.5
Iran		5.0	7.8	7.9	
Iraq	0.0	0.0	0.0	0.0	57.5
Sudan	0.0	68.0	119.4	130.9	34.3
Syria	0.0	27.6	139.0	115.0	8.9
Yemen	0.0	0.0	77.7	49.9	19.8
Resource Poor Labor Rich	**1.1**	**45.6**	**92.5**	**78.8**	**65.1**
Egypt, Arab Rep.	0.0	83.4	76.6	29.3	16.6
Jordan	0.0	47.2	207.2	131.2	63.3
Lebanon	5.4	5.3	19.2	124.1	167.2
Morocco	0.0	51.7	96.9	56.2	29.0
Tunisia	0.0	40.4	62.5	53.0	49.5
Turkey	**0.0**	**27.8**	**32.7**	**43.8**	**41.0**

Source: WBI and WEO

Table 5a: Deficit and Debt over GDP Before and After Stabilization

	Timing of Stabilization	Dates of IMF program (Since mid-1980s)	Deficit 3 Years Av. Before	Deficit 3 Years Av. After	Deficit 5 Years Av. After	Debt Year of Stab.	Debt 3 Years After	Debt 5 Years After
Average			***-10.5***	***-5.4***	***-5.0***	***104.1***	***90.3***	***85.3***
Egypt	1991	1987-88, 1991-93, 1993-96, 1996-98	-5.1	-0.8	-0.6	164.6	128.4	108.2
Tunisia	1986	1986-88, 1988-92, 2013-15	-10.3	-7.7	-6.3	56.5	53.4	60.7
Morocco 1	1985	1983-1985, 1985-	-16.9	-11.6	-10.0	85.6	114.3	101.9
Morocco 2	1990	86, 1986-88	-11.1	-1.9	-2.7	101.9	87.6	80.9
Jordan 1	1989	1989-91, 1992-94,	-14.4	-0.4	0.1	216.3	151.4	126.3
Jordan 2	1999	1994-96, 1996-99, 1999-02, 2002-04, 2012-15	-3.3	-2.8	-2.0	108.0	99.7	91.8
Turkey 1	1994	1984-85, 1994-96,	-10.5	-12.0	-11.9	57.7	46.8	42.0
Turkey 2	1999	1999-2002, 2002-05, 2005-08	-12.6	-13.6	-11.5	42.0	68.4	57.6
Algeria	1989	1989-90, 1991-92, 1994-95, 1995-98	N/A	2.5	-0.5	N/A	62.9	98.4

Source: IMF

Table 5b: Real GDP Growth and Inflation Before and After Stabilization

	Timing of Stab.	Growth 3 Years Av. Before	Growth 3 Years Av. After	Growth 5 Years Av. After	Inflation 3 Years Av. Before	Inflation 3 Years Av. After	Inflation 5 Years Av. After
Average		***3.1***	***3.6***	***3.6***	***22.8***	***22.4***	***20.1***
Egypt	1991	3.1	2.5	3.4	18.8	13.7	11.5
Tunisia	1986	5.4	3.1	4.1	8.4	7.7	7.5
Morocco 1	1985	0.1	5.4	4.5	9.7	4.6	4.6
Morocco 2	1990	3.4	0.6	1.1	2.7	6.6	6.2
Jordan 1	1989	3.1	5.2	5.0	2.2	9.5	7.0
Jordan 2	1999	2.8	5.1	5.6	4.2	1.4	1.9
Turkey 1	1994	5.0	7.2	4.3	67.4	85.2	81.0
Turkey 2	1999	5.9	2.4	4.4	83.5	51.5	37.7
Algeria	1989	-0.9	0.6	-0.3	8.6	22.3	23.3

Source: IMF

Table 6: Peak, Low, and Recent Peak, Total Expenditures, As a Share of GDP

	Available Data	Peak Expenditure Eh	Date of peak	Lowest Expenditure El	Date of lowest	Bulge Eh-El	Last Peak	Date of Last peak
RALP		***53.1***		***30.0***		***22.5***	***42.1***	
Bahrain	1974-2011	53.1	1986	25.1	2000	28.0	36.0	2002
Kuwait	1972-2011	57.2	1986	35.7	2007	21.5	49.7	2008
Libya	1990-2011	N/A	N/A	26.7	1992	N/A	66.6	2011
Oman	1967-2011	56.7	1986	30.3	1997	26.4	41.1	2009
Qatar	1990-2011	51.4	1993	29.4	2003	22.0	32.2	2009
KSA	1990-2011	57.6	1987	32.6	1995	25.0	42.5	2009
UAE	1991-2011	42.3	1996	30.2	2006	12.1	27.0	2009
RALR		***43.3***		***22.2***		***21.1***	***35.4***	
Algeria	1971-2011	38.1	1983	25.7	1990	12.4	41.9	2009
Iran	1960-2009	43.6	1980	19.2	1991	24.4	31.6	2006
Syria	1962-2010	48.2	1980	21.8	1990	26.4	32.9	2003
RPLR		***53.2***		***27.9***		***25.2***	***38.1***	
Egypt	1960-2011	61.5	1982	25.1	1998	36.4	35.7	2006
Jordan	1960-2011	52.5	1980	29.9	1992	22.6	39.8	2009
Lebanon	1990-2011	55.7	1994	29.6	2011	26.0	42.3	2000
Morocco	1960-2011	51.0	1981	26.2	1996	24.8	37.7	2011
Tunisia	1960-2011	45.1	1984	28.8	1998	16.2	35.0	2011

Source: own calculations based on IMF

Table 7: Peak, Low, Recent Peak Subsidies and Public Investment, As a Share of GDP

	Peak Subsidy Sh	Low Subsidy Se	Recent peak Subsidy	Peak Investment Ih	Low Investment Ie	Recent peak Investment	[(Sh-Se) + (Ih-Ie)]/B
RALP	***1.2***	***1.5***	***4.6***	***14.8***	***6.8***	***10.2***	***0.3***
Bahrain	N/A	1.8	N/A	N/A	4.3	9.1	N/A
Kuwait	N/A	4.5	6.6	17.6	4.3	3.7	N/A
Libya	N/A	0.2	13.7	N/A	8.3	7.6	N/A
Oman	2.9	0.5	1.9	23.7	11.4	18.8	0.6
Qatar	0.0	1.9	3.0	6.8	7.9	10.6	-0.1
KSA	1.8	1.6	2.3	16	5	12	0.4
UAE	0.0	0.0	0.0	10.1	6.7	9.4	0.3
RALR	***11.4***	***6.1***	***7.9***	***15.6***	***7.7***	***19.9***	***0.7***
Algeria	7.1	5.2	10.6	18.9	8.2	38.5	1.0
Iran	6.9	0.0	2.8	10.4	7.5	10.1	0.4
Syria	20.2	13.1	10.4	17.6	7.4	11.2	0.7
RPLR	***9.7***	***1.1***	***4.4***	***14.5***	***6.1***	***5.0***	***0.8***
Egypt	22.7	1.5	8.8	20.7	14.1	8.0	0.8
Jordan	7.0	2.0	1.5	17.7	6.1	8.2	0.7
Lebanon	1.6	4,8	0.4	9.3	1.7	3.1	N/A
Morocco	5.6	0.6	6.1	8.4	3.0	4.5	0.4
Tunisia	11.4	0.2	5.4	16.5	5.7	1.4	1.4

Source: own calculations based on IMF

Table 8: Investment, Public and Private

Countries	Public investment			Private investment		
	1971-1990	1991-2000	2001-10	1971-1990	1991-2000	2001-2010
Resource Abundant						
Labor Poor	11.18	6.92	7.75	10.98	13.21	14.13
Bahrain	10.99	4.59	6.47	12.74	8.17	16.50
Kuwait	6.96	6.59	5.94	10.50	9.96	9.94
Libya			14.89			3.18
Oman	10.51	8.24	9.08	15.86	13.07	15.45
Qatar	13.78	9.19	8.82	5.68	15.55	23.84
Saudi Arabia	18.09	6.06	5.42	2.09	13.28	12.82
United Arab Emirates	6.75	6.85	3.65	18.99	19.22	17.17
Resource Abundant						
Labor Rich	11.57	6.64	8.29	15.24	14.55	13.04
Algeria	11.86	7.24	11.86	22.74	18.38	12.22
Iran, Islamic Rep.	13.08	10.28	9.60	15.14	16.43	17.94
Iraq						
Sudan	4.96	0.93	4.79	8.07	10.51	16.85
Syrian Arab Republic	15.01	10.75	10.36	10.27	12.01	10.05
Yemen, Rep.	7.18	3.99	6.78	3.32	15.44	10.40
Resource Poor Labor						
Rich	11.90	8.36	5.23	13.53	16.10	18.73
Egypt, Arab Rep.	18.46	13.98	8.25	9.62	5.58	10.30
Jordan	13.49	9.27	7.29	15.93	17.61	17.04
Lebanon	1.70	5.50	2.68	16.10	22.82	22.32
Morocco	6.87	4.18	14.36	15.43	18.23	13.92
Tunisia	14.04	8.85	3.42	12.32	16.26	19.89

Source: own calculations based on IMF

Table 9: Peak, Low, and Recent Peak: Expenditures on Wages, and Public Employment

	Peak Wage bill Wh	Low Wage Bill We	Recent Peak	Bulge Wh-We	Average 1990s	Average 2000s	Average 2010s	Public Employment % LF 1990s	Public Employment % LF 2005-2010*
RALP	***15.7***	***9.3***	***13.4***	***4.9***	***12.5***	***8.3***	***9.7***		***62.3***
Bahrain	20.9	13.2	14.6	7.7	15.7	12.2	10.5		33.9
Kuwait	14.5	8.3	8.1	6.3	16.3	11.1	10.1		80.1
Libya	N/A	12.9	34.8	N/A	14.1	9.0	23.4		65.0
Oman	8.9	8.0	7.8	0.9	8.6	7.6	6.8		47.1
Qatar	16.4	7.3	6.1	N/A	15.5	6.6	4.7		86.7
UAE	4,85	2.2	3.5	N/A	5.0	3.0	2.8		73.3
KSA	18	13.2	19	4.8	na	na	na		49.9
RALR	***10.7***	***7.5***	***7.3***	***3.2***	***7.6***	***6.7***	***11.0***		***22.3***
Algeria	7.8	9.3	8.8	-1.5	8.9	7.2	11.0	58	30.0
Iran	16.2	8.0	7.7	8.1	9.4	7.8	N/A		16.0
Syria	8.1	5.2	5.5	2.9	4.6	5.0	N/A	29	21.0
RPLR	***12.3***	***9.5***	***10.3***	***3.3***	***9.9***	***9.6***	***9.9***		***22.3***
Egypt	9.7	5.9	6.8	3.8	6.1	6.7	6.4	32	27.0
Jordan	20.9	12.8	15.3	8.1	14.5	13.8	13.7	49	34.0
Lebanon	9.1	8.3	6.9	N/A	8.1	5.8	8.1		17.6
Morocco	12.1	10.4	11.7	1.7	10.6	11.4	11.3	26	11.0
Tunisia	9.9	10.2	10.6	-0.3	10.0	10.1	10.1	32	22.0

Notes: For GCC, percent of nationals
Source: own calculations based on IMF

Table 10: Peak, Low, Recent Peak, and Decade Average Expenditures on Health and Education, As a Share of GDP

	Peak H+Eh	Low H+Ee	recent Peak	Bulge HEh-HEe	H+E Average 1990s	H+E Average 2000s	H+E Average 2010s	HDI Ranking Average 80,90,00,10
RALP	***9.5***	***6.5***	***7.8***	***3.0***	***7.5***	***6.1***	***6.1***	
Bahrain	7.9	5.4	6.3	2.5	6.1	6.0	6.2	38, 40, 38, 48
Kuwait	11.2	5.6	6.9	5.6	9.7	7.3	7.3	31, 41, 39, 51
Libya	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Oman	8.6	6.6	6.9	2.0	6.8	6.4	6.0	145, 158, 169, 84
Qatar	N/A	N/A	5.9	N\A	N\A	4.7	4.9	21, 32, 32, 37
KSA	10.2	8.5	12.7	1.7	na	na	na	
RALR	***6.5***	***3.8***	***5.6***	***2.7***	***6.4***	***5.4***	***N/A***	
Algeria	N/A	N/A	8.3	N\A	10.4	6.8	N\A	70, 81, 84, 93
Iran	9.9	5.6	2.9	4.3	6.1	3.9	N\A	75, 86, 75, 75
Syria	3.0	2.0	N/A	1.0	2.8	N\A	N\A	64, 83, 90, 115
RPLR	***6.9***	***5.7***	***6.5***	***1.2***	***6.1***	***6.4***	***6.0***	
Egypt	6.5	5.5	5.7	1.0	5.4	6.0	5.1	81, 92, 91, 111
Jordan	5.3	6.2	7.8	-0.9	7.5	8.1	6.9	59, 72, 77, 99
Lebanon	N/A	2.7	3.6	N\A	3.5	3.4	2.8	137, 151, 163, 74
Morocco	7.8	6.9	8.3	0.9	6.7	7.2	8.0	85, 99, 107, 130
Tunisia	7.9	7.1	7.3	0.8	7.7	7.3	7.2	72, 85, 80, 92

Source: own calculations based on IMF

Table 11: Expenditure on Security and Military, Shares of GDP

	Peak Security	Low Security	Recent Peak Security	Peak Defense	Low Defense	Recent peak Defense
RALP	***6.1***	***2.5***	***2.0***	***10.4***	***6.2***	***5.7***
Bahrain	N/A	3.2	3.3	5.6	4.0	4.7
Kuwait	6.1	2.4	2.5	7.3	3.7	3.0
Libya	N/A	N/A	N/A	N/A	6.7	0.0
Oman	N/A	1.8	0.4	23.8	11.0	9.6
Qatar	N/A	N/A	1.7	4.6	3.3	2.0
UAE	N/A	N/A	N/A	3.0	4.3	5,32
KSA*				18.1	10.1	15
RALR	***0.0***	***0.7***	***1.2***	***14.5***	***3.2***	***4.6***
Algeria	N/A	N/A	1.8	2.0	1.5	3.8
Iran	0.0	0.9	1.8	5.7	1.7	3.7
Syria	0.0	0.6	0.0	35.9	6.4	6.2
RPLR	***1.6***	***1.8***	***2.4***	***6.4***	***3.7***	***2.8***
Egypt	1.7	1.4	1.7	7.1	2.8	2.6
Jordan	N/A	2.0	4.1	10.7	6.6	5,89
Lebanon	N/A	1.4	1.3	4.1	3.6	3.6
Morocco	N/A	N/A	N/A	7.2	3.9	3.4
Tunisia	1.5	2.4	2.5	3.0	1.7	1.5

Notes: * Defense + security
Source: own calculations based on IMF

Table 12: Composition of Revenues, Share of GDP

	Peak Non-Tax	Low Non-Tax	recent Peak	Peak Tax	Low Tax	recent Peak	peak Grants	Low Grants	Recent Peak Grants
RALP	***42.7***	***34.7***	***39.4***	***4.5***	***3.9***	***2.9***	***2.6***	***1.0***	***0.7***
Bahrain	32.7	33.0	30.6	10.0	1.9	1.5	3.5	0.6	1.2
Kuwait	89.2	68.1	59.3	2.1	1.0	0.9	0.0	0.0	0.0
Libya	N/A	18.7	48.6	N/A	7.9	1.6	N/A	0.0	0.2
Oman	24.1	22.1	33.9	7.9	8.8	3,49	1.7	0.3	0.3
Qatar	41.0	33.8	40.6	0.9	2.0	6.9	0.0	0.0	0.0
UAE	26.7	32.7	23.3	1.8	2.0	3.4	8.1	4.9	2.7
RALR	***21.3***	***12.9***	***21.6***	***8.7***	***10.5***	***12.2***	***7.2***	***1.2***	***0.3***
Algeria	N/A	16.7	27.0	N/A	12.2	9.8	N/A	0.0	0.0
Iran	14.7	10.2	26.6	6.9	6.7	8.2	0.0	0.0	0.1
Syria	27.9	11.7	11.1	10.5	12.7	18.8	14.5	3.6	0.7
RPLR	***12.3***	***7.5***	***11.1***	***20.0***	***19.3***	***17.9***	***4.4***	***1.0***	***0.6***
Egypt	18.3	6.8	12.7	28.5	16.0	15.8	0.3	0.6	0.4
Jordan	21.4	11.5	15.7	14.0	23.0	17.1	17.2	3.8	2.0
Lebanon	7.1	6.1	6.7	10.8	17.5	11.9	3.1	0.1	0.4
Morocco	4.7	5.4	9.8	21.2	20.9	23.8	1.4	0.0	0.2
Tunisia	9.9	8.0	10.4	25.8	19.2	20.9	0.1	0.4	0.3

Source: own calculations based on IMF

Table 13: Composition of Taxes

	Direct Over Indirect Taxes Before Adjustment	Direct Over Indirect Taxes After Adjustment	Date of Adjustment	Date of Oil Shock Highest
RALP	***227.0***	***122.2***		
Bahrain	22.0	11.6	N/A	**1986**
Kuwait	84.5	34.5	N/A	**1986**
Libya	N/A	N/A	N/A	N/A
Oman	1012.5	539.2	N/A	**1986**
Qatar	16.1	24.2	N/A	**1993**
UAE	0.0	1.7	N/A	**1996**
RALR	***39.8***	***47.3***		
Algeria	N/A	39.6	**1989**	1983
Iran	55.2	36.1	N/A	**1980**
Syria	24.4	66.1	N/A	**1980**
RPLR	***25.0***	***28.0***		
Egypt	36.4	56.9	**1991**	1982
Jordan	19.2	20.4	**1989**	1980
Lebanon	16.9	13.0	N/A	**1994**
Morocco	29.8	27.3	**1983**	1981
Tunisia	22.9	22.2	**1986**	1984

Source: own calculations based on IMF

Annex

IMF Agreements: Lending Arrangements (In 1000s of SDRs)

	Date of Arrangement	Date of expiration	Amount Agreed	Amount Drawn
Algeria:				
Extended Fund Facility	22-May-95	21-May-98	1,169,280	1,169,280
Standby Arrangement	27-May-94	22-May-95	457,200	385,200
Standby Arrangement	3-Jun-91	31-Mar-92	300,000	225,000
Standby Arrangement	31-May-89	30-May-90	155,700	155,700
Total			2,082,180	1,935,180
Egypt				
Standby Arrangement	11-Oct-96	30-Sep-98	271,400	0
Extended Fund Facility	20-Sep-93	19-Sep-96	400,000	0
Standby Arrangement	17-May-91	31-May-93	234,400	147,200
Standby Arrangement	15-May-87	30-Nov-88	250,000	116,000
Total			1,155,800	263,200
Jordan				
Standby Arrangement	3-Aug-12	2-Aug-15	1,364,000	682,000
Standby Arrangement	3-Jul-02	2-Jul-04	85,280	10,660
Extended Fund Facility	15-Apr-99	31-May-02	127,880	127,880
Extended Fund Facility	9-Feb-96	8-Feb-99	238,040	202,520
Extended Fund Facility	25-May-94	9-Feb-96	189,300	130,320
Standby Arrangement	26-Feb-92	25-Feb-94	44,400	44,400
Standby Arrangement	14-Jul-89	13-Jan-91	60,000	26,800
Total			2,108,900	1,224,580
Morocco				
Precautionary and Liquidity Line	3-Aug-12	2-Aug-14	4,117,400	0
Standby Arrangement	31-Jan-92	31-Mar-93	91,980	18,396
Standby Arrangement	20-Jul-90	31-Mar-91	100,000	48,000
Standby Arrangement	30-Aug-88	31-Dec-89	210,000	210,000
Standby Arrangement	16-Dec-86	30-Apr-88	230,000	230,000
Standby Arrangement	12-Sep-85	15-Dec-86	200,000	10,000
Standby Arrangement	16-Sep-83	15-Mar-85	300,000	300,000
Total			5,249,380	816,396
Tunisia				
Standby Arrangement	7-Jun-13	6-Jun-15	1,146,000	98,800
Extended Fund Facility	25-Jul-88	24-Jul-92	207,300	207,300
Standby Arrangement	4-Nov-86	31-May-88	103,650	91,000
Total			1,456,950	397,100
Turkey				
Standby Arrangement	11-May-05	10-May-08	6,662,040	6,662,040
Standby Arrangement	4-Feb-02	3-Feb-05	12,821,200	11,914,000
Standby Arrangement	22-Dec-99	4-Feb-02	15,038,400	11,738,960
Supplemental Reserve Facility	21-Dec-00	20-Dec-01	5,784,000	5,784,000
Standby Arrangement	8-Jul-94	7-Mar-96	610,500	460,500
Standby Arrangement	4-Apr-84	3-Apr-85	225,000	168,750
Total			35,357,140	30,944,250