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Economic Diversification and Governance Challenges in MENA Oil Exporters: A Comparative Study

Presented By:

Matallah Siham

PhD in Economics, Lecturer in the Department of Economics, University of Oran 2, Algeria.

1. Introduction

MENA oil exporters are less diversified than they should be, and fingers are pointed at poor governance in general, and at corrupt practices in particular, for mismanagement and dissipation of oil revenues. In oil-rich MENA countries, many large infrastructure projects have been delivered late and fell into the trap of going over budget mainly due to bad governance and corruption.

As oil revenues fall and fossil fuel age fades, oil-rich MENA governments could soon face severe social unrest (Arezki et al. 2018). These facts ultimately sow the seeds of uncertainty about MENA oil exporters' diversification capacity and question their ability to create more employment opportunities and absorb the millions of young people entering the labor force each year.

1. Introduction

This paper thus aims to unearth very interesting and research-worthy aspects of this intractable situation by testing, on the one hand, the impact of oil rents on economic growth and the main symptoms of the resource curse phenomenon in oil-abundant MENA countries, and, on the other hand, by investigating the role of governance in avoiding the resource curse and turning oil rents into a tool for economic diversification in 11 MENA oil exporters (Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates, and Yemen) over the period 1996-2018.

1. Introduction

2. Theoretical and Empirical Review on Economic diversification and Governance Quality

3. Economic Diversification in MENA Oil Exporters

4. Good Governance in MENA Oil Exporters

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3. Economic Diversification in MENA Oil Exporters

Patterns of Services Export Diversification in MENA Oil Exporters

Figure 1. Diversification of Services Exports by MENA Oil Exporters (Below-Average Diversification of Services Exports), 1995–2014
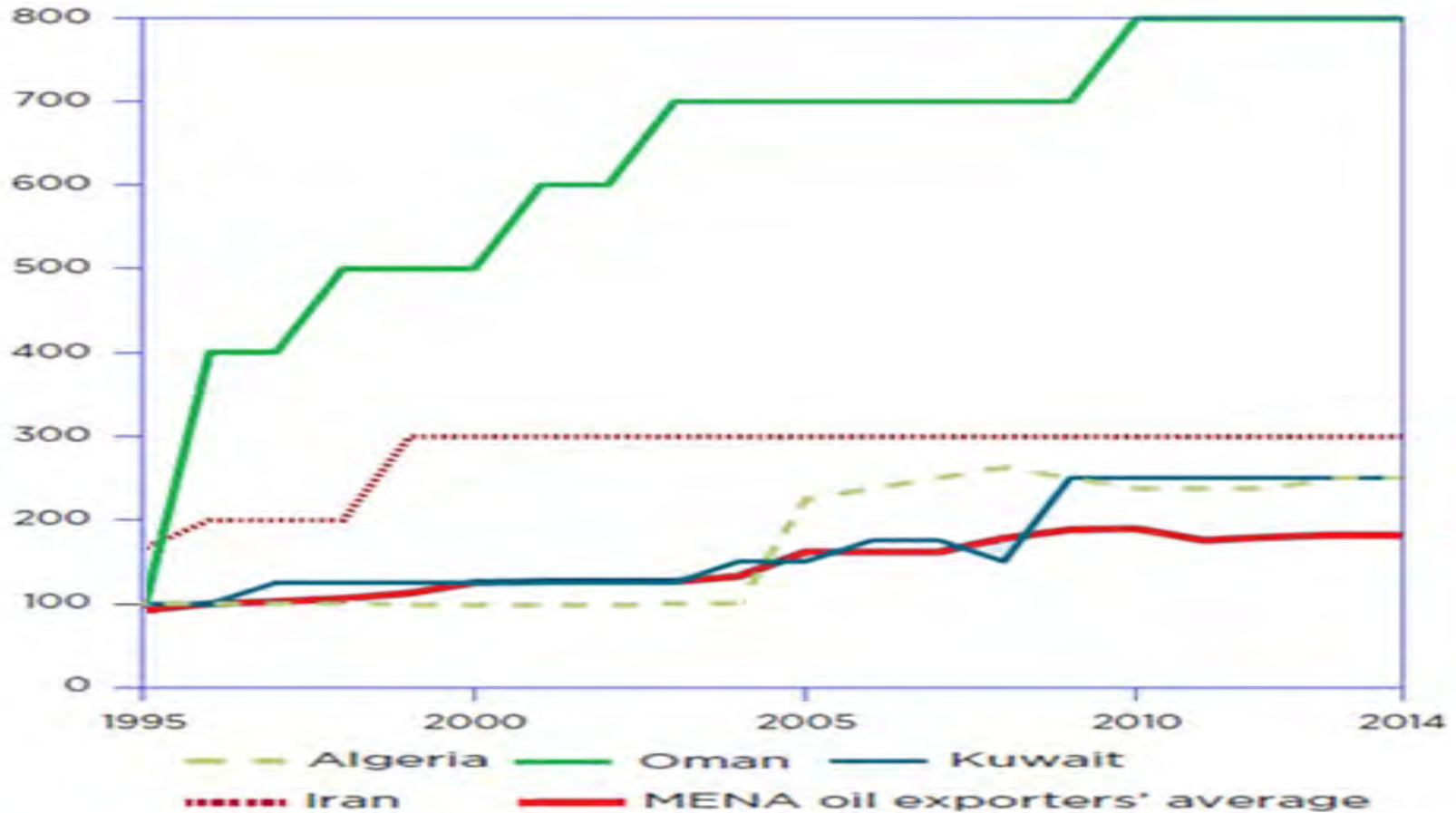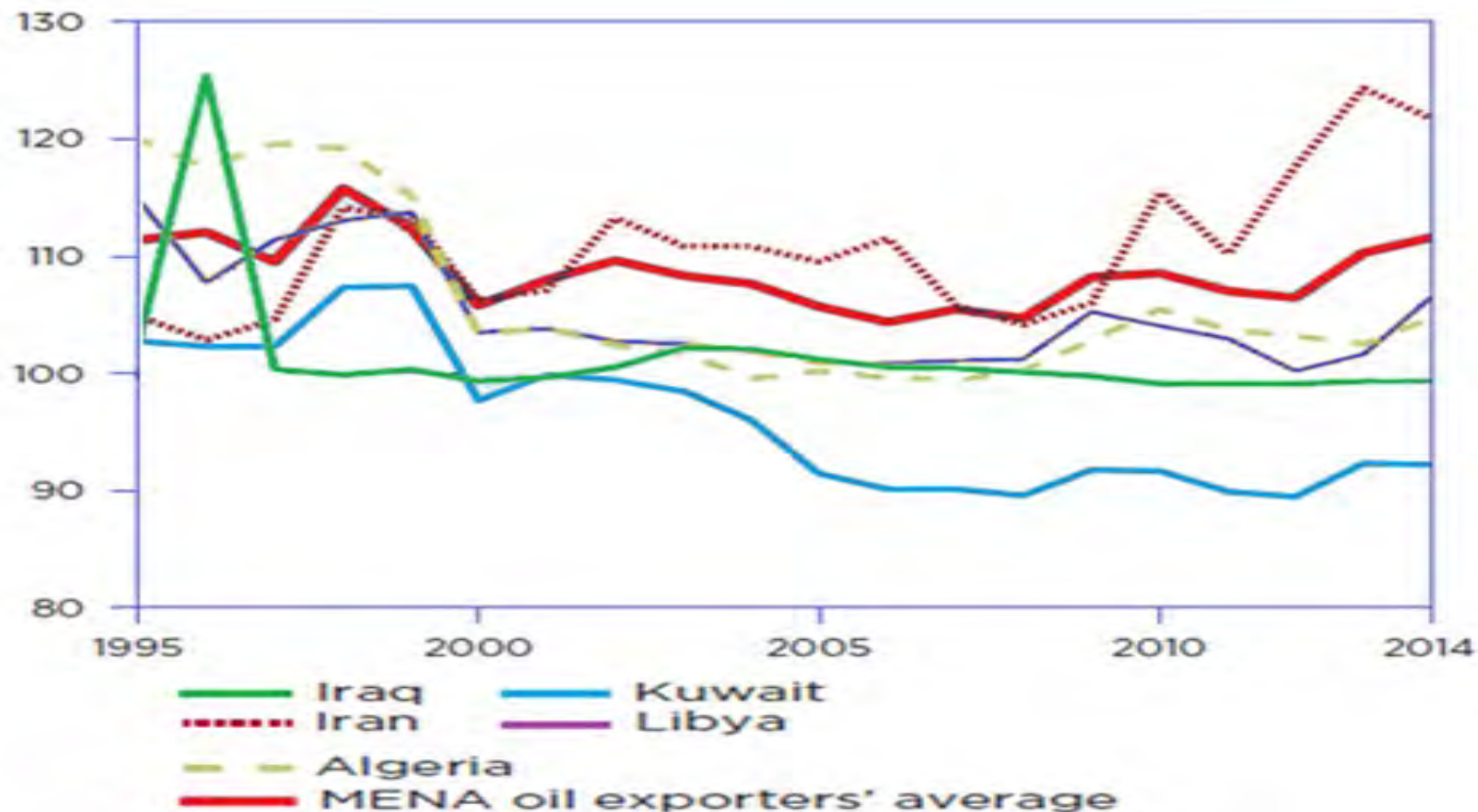

Number of services categories exported (1995 = 100)

Source: IMF Trade in Services database, 2017.

3. Economic Diversification in MENA Oil Exporters

Patterns of Goods Export Diversification in MENA Oil Exporters

Figure 2. Diversification of Goods Exports by MENA Oil Exporters (Below-Average Diversification of Goods Exports), 1995–2014
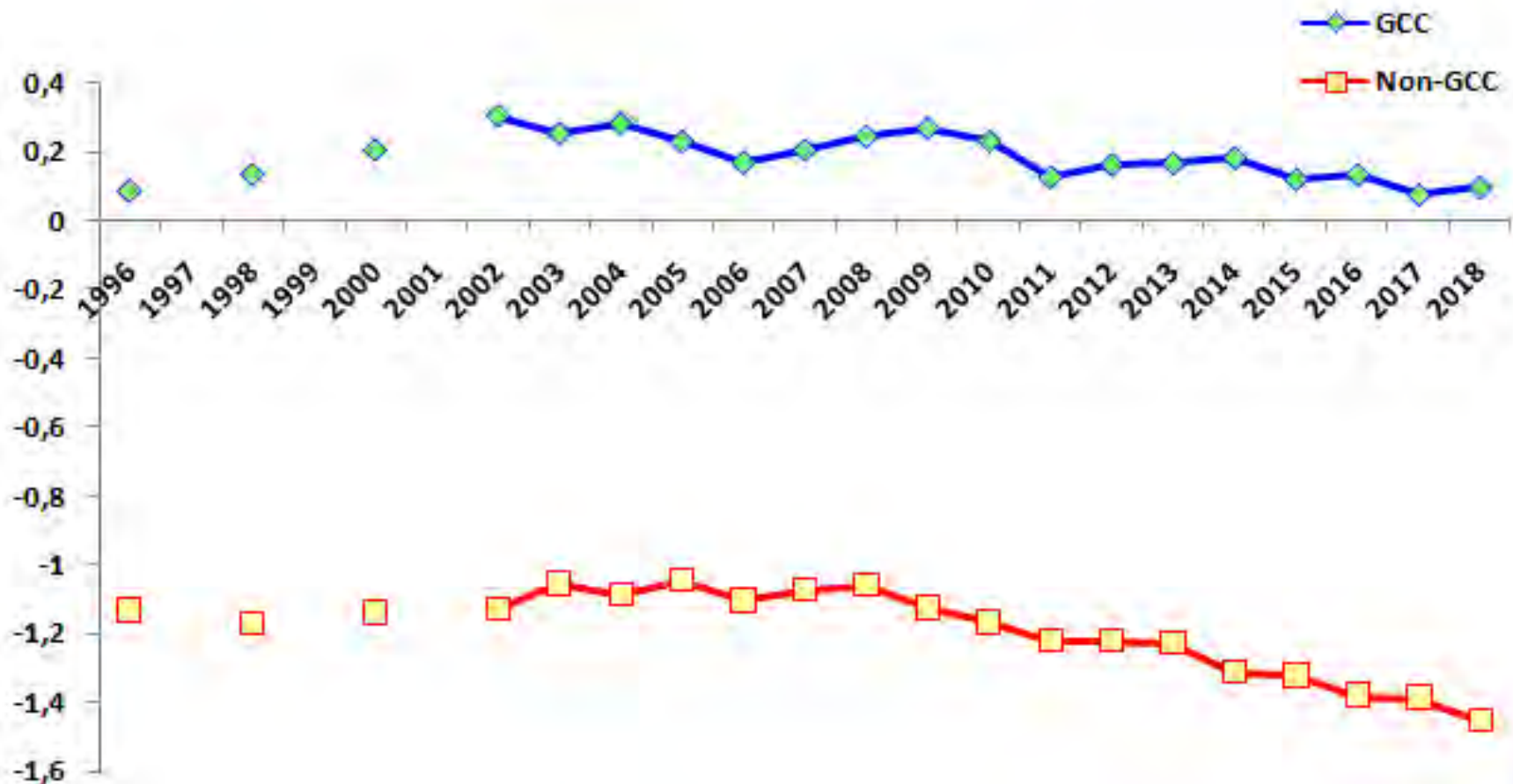

Inverse Theil index, in real terms (1995 = 111)

Source: IMF, The Diversification Toolkit: Export Diversification and Quality Databases, https://www.imf.org/external/np/res/dfidimf/diversification.htm (accessed 28/10/2019).
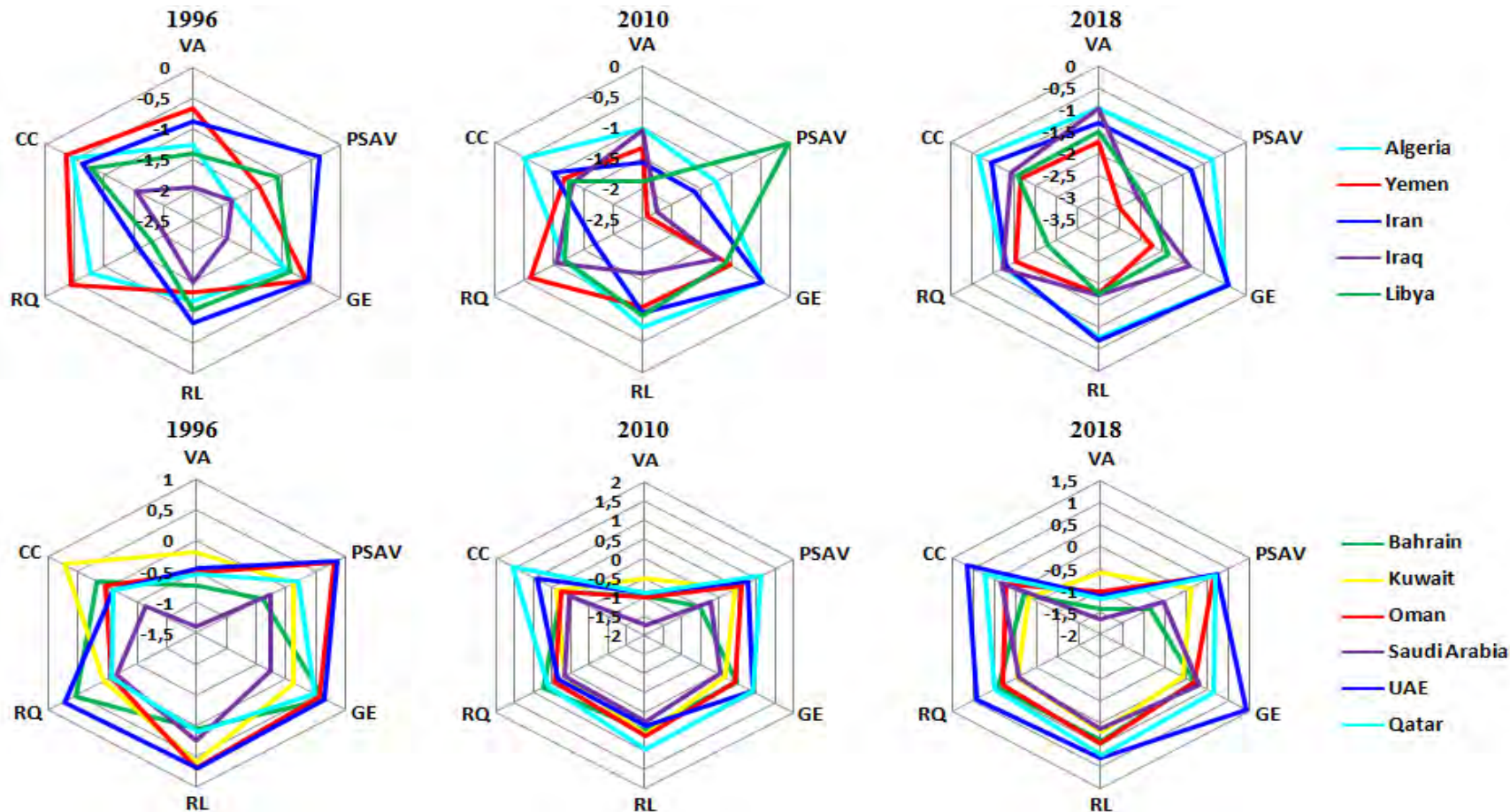
4. Good Governance in MENA Oil Exporters

Figure 3. Governance Index (The Simple Average of Six Worldwide Governance Indicators) in Oil-Abundant MENA Countries, 1996-2018.

4. Good Governance in MENA Oil Exporters

Figure 4. Governance Indicators in Oil-Abundant MENA Countries, 1996, 2010, 2018.

5. Successful Economic Diversification Experiences of Malaysia, Canada and Norway

Figure 5. Governance Index in Oil-Abundant MENA Countries, Malaysia, Canada and Norway, 2002-2018.
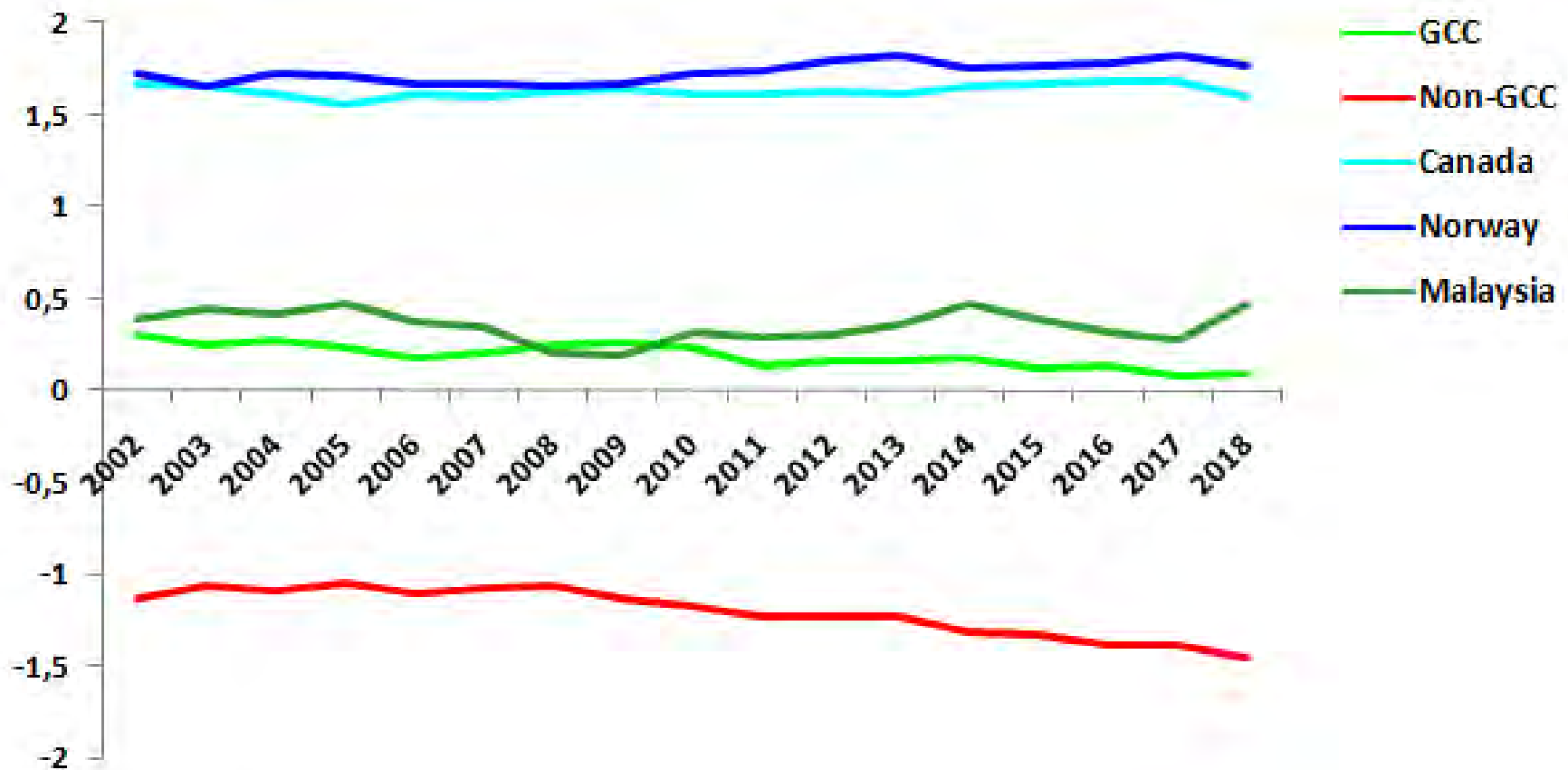
Source: World Bank Governance Indicators, the data are available online at: http://info.worldbank.org/governance/wgi/index.asp (accessed 28/10/2019).

6. Data and Empirical Results

A. Data

The present paper aims, on the one hand, to test the impact of oil rents on economic growth and examine the main symptoms of the resource curse phenomenon in oil-abundant MENA countries, and on the other hand, to investigate the role of governance in avoiding the resource curse and turning oil rents into a tool for economic diversification in 11 MENA oil exporters (Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates, and Yemen). This paper aims also to compare the diversification experience of Canada, Norway and Malaysia to that of GCC countries over the period 1996-2018, this time period has been chosen on the basis of data availability for the following variables:

GDP: GDP per capita growth (annual %) is used as a proxy for economic growth, from the World Development Indicators database.

OILR: Oil rents (% of GDP) (they represent the difference between the value of crude oil production at world prices and total costs of production), from the World Development Indicators database.

AGR: Agriculture, value added (% of GDP), from the World Development Indicators database.

IND: Industry, value added (% of GDP), from the World Development Indicators database.

6. Data and Empirical Results

A. Data

SER: Services, etc., value added (% of GDP), from the World Development Indicators database.

DIV: The export diversification index indicates whether the export structure of each country or country grouping differs from the world patterns, this index takes values between 0 (a high degree of diversification) and 1 (a low degree of diversification), the data are from UNCTAD's database.

CONC: The export concentration index shows how exports of individual countries or country groupings are concentrated on several products or otherwise distributed in a more homogeneous manner among a series of products, this index takes values between 0 (minimum concentration) and 1 (maximum concentration), the data are from UNCTAD's database.

GI: presents the Governance Index which is constructed as a simple average of the following World Bank's Worldwide Governance Indicators: Voice and Accountability (VA), Political Stability and Absence of Violence (PSAV), Government Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL), Control of Corruption (CC), these indicators range from -2.5 (bad) to 2.5 (good), the data are from the World Bank's Worldwide Governance Indicators (WGI) database.

EF: Economic Freedom is used as a proxy for economic institutions, introduced by Heritage Foundation and Wall Street Journal, this indicator is graded on a scale of 0 (repressed) to 100 (free).

B. *Analysis of Empirical Results*

Table 1. **Regression Results for 11 Oil-Abundant MENA countries**

Independent Variables	Pooled OLS Model	Fixed Effects Model	Random Effects Model
	Dependent Variable: GDP		
	Coefficient Estimates (P-value)		
Constant	-13.13831 (0.0015)***	-11.66087 (0.0000)***	-10.54446 (0.1970)
DIV	-16.16698 (0.0039)***	-11.16342 (0.0005)***	-8.289686 (0.4557)
GI	0.306695 (0.5609)	0.699690 (0.0467)**	0.085789 (0.9393)
OILR	0.049343 (0.0294)**	0.126598 (0.0000)***	0.160828 (0.0007)***
R-squared	0.122317	0.283594	0.056675
Prob (F-statistic)	0.000012	0.000000	0.009721

Significant at 1% (***), 5 %(**), 10% (*).

Source: *Author's Computation Using Eviews 8.0.*

B. Analysis of Empirical Results
Table 2. <u>Regression Results for 11 Oil-Abundant MENA countries</u>

	(a) OLS FE	(b) OLS FE	(c) OLS FE	(d) OLS FE	(e) OLS FE	(f) OLS FE	(g) OLS FE
Dependent Variable	GDP	GDP	DIV	CONC	CONC	GI	EF
Constant	-18.09399 (0.0029)***	-34.77411 (0.0000)***	0.683810 (0.0000)***	0.466419 (0.0000)***	0.227382 (0.0008)***	-0.595599 (0.0000)***	61.73459 (0.0000)***
AGR		0.103498 (0.7604)			0.000536 (0.8926)		
IND		2.78E-10 (0.0000)***			-1.19E-12 (0.1166)		
SER		0.345761 (0.0000)***			-0.004406 (0.1631)		
OILR	0.618952 (0.0021)***	0.727076 (0.0000)***	0.002893 (0.0000)***	0.005241 (0.0000)***	0.007519 (0.0000)***	-0.006318 (0.0009)***	-0.080151 (0.0888)*
R²	0.241860	0.549680	0.322692	0.851591	0.899741	0.938502	0.930814
Prob (F-statistic)	0.004053	0.000000	0.000000	0.000000	0.000000	0.000000	0.000000

Significant at 1% (***), 5% (**), 10% (*). P-values are in parentheses.

Source: *Author's Computation Using Eviews 8.0.*

B. Analysis of Empirical Results
Table 3. Regression Results for 11 Oil-Abundant MENA countries

Dependent Variable: DIV

	(a) Panel GMM-FE	(b) Panel GMM-FE	(c) Panel GMM-FE	(d) Panel GMM-FE	(e) Panel GMM-FE	(f) Panel GMM-FE	(g) Panel GMM-FE	(h) Panel GMM-FE
Constant	0.367474 (0.0104)**	0.853002 (0.0000)***	1.339733 (0.0000)***	0.915633 (0.0000)***	0.701915 (0.0000)***	0.631846 (0.0000)***	0.708585 (0.0000)***	0.601348 (0.0000)***
GI	-0.192156 (0.0106)**							
GI*OILR	-0.007666 (0.0013)***							
VA		-0.071469 (0.0047)***	-0.412104 (0.0008)***					
VA*OILR			-0.008588 (0.0057)***					
PSAV		-0.056119 (0.0096)***		-0.063466 (0.0069)***				
PSAV*OILR				-0.001254 (0.0204)**				
GE		-0.182716 (0.0590)*			-0.064580 (0.0280)**			
GE*OILR					-0.005584 (0.0026)***			
RQ		-0.191089 (0.0247)**				-0.048634 (0.0248)**		
RQ*OILR						-0.003295 (0.0058)***		
RL		-0.451005 (0.0019)***					-0.077695 (0.0396)**	
RL*OILR							-0.005563 (0.0042)***	
CC		-0.151823 (0.0798)*						-0.072646 (0.0236)***
CC*OILR								-0.003039 (0.0076)***
OILR	0.013393 (0.0040)***		0.013399 (0.0053)***	0.004551 (0.0081)***	0.003059 (0.0170)**	0.004783 (0.0189)**	0.002514 (0.0343)**	0.005356 (0.0285)**
R^2	0.619694	0.629297	0.693514	0.879456	0.661667	0.897526	0.574683	0.892747
J-statistic [p-value]	0.130374 [0.718045]	3.388249 [0.183760]	2.242111 [0.325936]	4.147818 [0.125693]	1.166515 [0.558077]	2.008764 [0.366271]	1.986429 [0.370384]	3.953264 [0.138535]
N instruments	4	8	5	5	5	5	5	5
N countries	11	11	11	11	11	11	11	11
N observations	163	164	162	162	162	162	162	162

Significant at 1% (***), 5% (**), 10% (*). P-values are in parentheses.

Source: *Author's Computation Using Eviews 8.0.*

B. *Analysis of Empirical Results*

Table 4. Regression Results for 11 Oil-Abundant MENA countries

Dependent Variable: DIV

	(a) OLS FE -CNM-	(b) OLS FE -CNM-	(c) OLS FE -GCC-	(d) OLS FE -GCC-
Constant	0.517036 (0.0000)***	0.770812 (0.0000)***	0.677867 (0.0000)***	0.787644 (0.0000)***
GI	-0.114443 (0.0000)***		-0.232673 (0.0001)***	
GI*OILR	-0.031340 (0.0000)***		-0.005664 (0.0009)***	
OILR	-0.012219 (0.0315)**		0.002721 (0.0000)***	
VA		-2.280532 (0.0242)**		-0.013639 (0.1336)
PSAV		-0.049784 (0.0173)**		-0.009866 (0.2551)
GE		-0.268639 (0.0000)***		-0.135940 (0.0000)***
RQ		-0.515594 (0.0000)***		-0.058850 (0.0006)***
RL		-0.538839 (0.0000)***		-0.060662 (0.0333)**
CC		-1.248354 (0.0001)***		-0.033098 (0.0060)***
R^2	0.866291	0.739450	0.518288	0.616947
Prob (F-statistic)	0.000000	0.000000	0.000000	0.000000

Significant at 1% (***), 5% (**), 10% (*). P-values are in parentheses.

Source: *Author's Computation Using Eviews 8.0.*

7. Conclusion

The need to accelerate economic diversification in oil-exporting MENA countries made deep and lasting economic reform more urgent but also more difficult. This will not only shape diversification priorities and policies, but will also profoundly change MENA oil exporters' long-standing economic models.

Oil-rich MENA governments must hold to structural reforms by:

- Restoring macroeconomic stability and fundamentally strengthening the regulatory framework for private sector development;

- Weeding out corruption and creating greater transparency in the public procurement system;

- Improving the quality of education and offering high-quality training in order to reduce the large skill gaps and mismatches hindering economic diversification; and

- Eliminating or at least reducing trade barriers obstructing intra-regional trade.

5. Conclusion

Oil-rich MENA governments need to improve the management of their public finances by:

- pursuing proactive fiscal policies, improving the management of public expenditures, reducing ballooning budget deficits, and phasing out energy consumption subsidies,

- Improving the efficiency of public spending and raising non-oil revenue,

- Using proper instruments for hedging and guarding against oil price risk, and

- Investing the largest part of the money derived from oil exports in sovereign wealth funds that have long investment horizons.

Thank You