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

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Abstract

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) over the period 1996-2018. This paper aims also to compare the diversification experience of Canada, Norway and Malaysia to that of GCC countries, by using pooled OLS, fixed effects, random effects and generalized method of moments (GMM) estimators. The main findings indicate that diversification, good governance and oil rents lay the foundation for sustainable growth in MENA oil exporters. Likewise, these economies have been diagnosed with resource curse. The results also reveal that governance is a key ingredient in the diversification recipe, while oil rents frustrate economic diversification by encouraging rent-seeking activities. The multiplicative interaction term between governance index and oil rents indicates that the combined effect of these two variables is effective in promoting diversification, in other words, the enhancement of MENA oil-exporters' governance situation allows oil rents to serve as a crucial funding source for many other sectors and enhance economic diversification. Moreover, the rate of improvement in diversification brought by governance is higher in GCC countries than in CNM group (Canada, Norway and Malaysia) because more efforts are needed from GCC countries to catch up with CNM group's governance levels; closing the governance gap determines how quickly GCC countries can promote economic diversification.

Key words: Economic Diversification, Oil Rents, Governance, MENA oil exporters.

JEL Classification Numbers: O43, O53, Q35, Q39.

1. Introduction

Due to tumbling oil prices and related uncertainties, MENA oil exporters have made some concrete efforts to diversify their export base beyond the oil sector for kicking the oil habit and cutting down direct dependency on oil revenues to zero, and it's worthwhile to note that these efforts have been underway for many decades now. The sharp drop in oil prices that began in 2014 has added to pressures for economic diversification and has refocused attention on persistent and pernicious structural political and economic issues amid escalating political conflicts and rising security challenges in the region. Despite some success in oil-exporting MENA countries' efforts to diversify their economies, the results have been so far pretty disappointing, raising enormous concerns about these countries' stability and its profound impact on the global economy.

There are three main reasons behind the need for export diversification in MENA oil exporters. First, oil revenues became more seriously disturbed by highly volatile and unstable oil prices than before. The U.S. shale revolution paved the way for the downturn and rapid decline in world oil prices after mid-2014. Large swings in oil prices have typically resulted from instability, wars, political unrest and civil conflicts that jeopardized some MENA countries' oil production and exports. The sharp decline in oil prices that has been associated with elevated ex-post volatility has exacted a sharp toll on many MENA oil producers and has prompted them to decrease energy-related subsidies, increase existing fees and taxes and cut spending for offsetting the shortfall in oil revenues. Some governments have been forced to go on a borrowing spree to fend off the crisis resulting in a substantial surge in public debt. Oil prices are more likely to turn lower as more production facilities resumed output in Libya, Venezuela and Iran where oil output has been repeatedly disrupted by several reasons. Second, the daunting employment challenge has moved to the centre of the political stage in most MENA countries. Social and political unrest that reached a tipping point was an inevitable consequence of the steep rise of youth unemployment. GCC governments are not an exception; they are seeking to create more productive private sector jobs for their citizens because creating high-paying and secure public sector jobs became fiscally unsustainable. Third, there is an increasing pressure on all countries around the world to reduce their use of fossil fuels in order to prevent global warming from becoming worse and avoid the worst effects of climate change. Oil-exporting MENA countries are increasingly worried about losing oil revenues by moving away from fossil fuels in the global fight against climate change (Mazarei, 2019).

A large body of literature has investigated prominent hindrances in the way of economic diversification in resource rich countries, such as:

- Poor governance and lack of appropriate economic incentive systems, particularly weak legal frameworks; lack of human resource development; restricted labor market access; and lack of access to mainstream financial services;
- Structural rigidities and imprudent macroeconomic policies, and other problems that are accompanied by an overvalued exchange rate;

- Industrial policies that defy new comparative advantages;
- Inward-oriented trade strategies such as intraregional trade barriers;
- Political economy factors that render oil-abundant countries more susceptible to rent seeking; and
- Geopolitical tensions, insecurity and ongoing conflicts (Mohaddes et al. (2019); Devarajan (2019); El-Anshassy et al. (2019); Arezki et al. (2018); Cherif, Hasanov, and Wang (2018); Hendrix (2017); IMF (2016); and Ross (2017)). This literature has reiterated the importance of improving governance, accelerating structural reforms, restoring budgetary balance, and wisely using oil rents.

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. These issues may lead to significant social and political consequences in this region that is currently affected by conflict and violence. 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.

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. It is extremely important to present a comprehensive performance comparison between MENA oil exporters and other oil exporters outside the region like Canada, Norway and Malaysia. It does not mean that those peers have designed and implemented optimal diversification policies. It rather points to a handful of factors that determine an effective economic diversification. Thus, this study also aims to compare the diversification experience of Canada, Norway and Malaysia to that of GCC countries that have made major strides in diversifying their export base relative to Non-GCC MENA oil exporters. Therefore, the paper is divided into seven sections. After introducing the topic in section 1, section 2 presents a theoretical and empirical review on economic diversification and governance quality, section 3 discusses economic diversification in MENA oil exporters, section 4 focuses on good governance in MENA oil exporters, section 5 highlights successful economic diversification experiences of Malaysia, Canada and Norway, section 6 introduces the data, explains the methodology, and analyzes the empirical results and finally section 7 concludes the paper and draws some policy implications.

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

Economic diversification is seen as a means of shielding against resource curse by expanding the breadth of exports and actively delinking economic growth from oil revenue flows. Greater economic diversification can lay the foundation for stable and sustained high non-oil growth (Parlee, 2015). Efficient diversification strategies can develop non-oil tradable sectors and reduce the concentration of economic activities in a few sectors where productivity gains are limited (Wiig and Kolstad, 2012). Several lessons can be drawn from the diversification experiences of oil rich countries like Canada, Malaysia and Norway that have embraced a wide range of manufacturing activities, and are therefore less economically dependent on oil revenues. In fact, success or failure of a diversification strategy appears to depend on an oil rich country's capacity to implement the necessary reforms ahead of the fall in oil revenues; they have done better than other oil exporters in sustaining significant growth over prolonged periods because they enjoy strong institutions and implement sound macroeconomic policies (Joya, 2015). The effective and lasting solution to the problem of unemployment in oil exporting countries lies in diversifying the economy and reviving the private sector. Consequently, economic diversification is deemed to be a cornerstone of the peacebuilding process. There appears to be a growing consensus that economic diversification is pretty good and it is a profitable mantra for pioneer economies, so why don't oil-rich countries diversify more?, the answer lies in the lack of clear guidelines and incentives to promote economic diversification, persistent lack of political will, poor governance, weak institutions, lack of appropriate infrastructure, large-scale government support for heavily energy-dependent industries, weak non-oil sectors, and the private sector's dependence on government-sponsored funding (Albassam, 2015). Omgba (2014) asserted that export diversification is significantly and positively affected by the time period elapsing between the date of the beginning of oil production and the date of political independence of oil-rich countries. Even more clearly, oil-abundant countries that started producing oil far away from their independence have had enough time to diversify their economies and export bases out of oil as compared to other oil-rich countries which have recently started exploiting their oil resources. However, political interests cannot be ignored because economic diversification can literally pose serious threats to some stakeholders who maximize their revenues from public oil rents. Entrenched power elites can and do abuse the political power for personal gain and will strive to retain their power and paralyze the diversification process that is able to deprive them of a share of oil revenues. In fragile governance frameworks, even if the diversification process is taking place in oil-rich countries, it will be heavily skewed towards political payoffs at the expense of societal ones, and that's exactly why policies and reforms have failed to deliver economic diversification in many oil-abundant countries (Wiig and Kolstad, 2012). Moreover, current institutional quality can be traced back to an oil-abundant country's colonization history. Settlement patterns at the time of colonization have exerted, and continue to exert, the greatest influence on oil-rich countries' governance quality and performance and have affected export diversification outcomes in a variety of ways. The process of diversification was faster in non-oil developing countries where colonizers established settlement colonies and created institutions conducive to business and investment,

than in oil-rich countries where colonists set up extractive institutions that persisted long after the colonial regime ended, mostly because of the ambitions and anxieties of the ruling elite (Acemoglu et al., 2001). Thus, colonization touched upon the most delicate chords of oil-rich countries' future development path. In fact, previously-colonized oil-rich countries that have succeeded in reshaping their institutions according to good principles have now much stronger and more diversified economic bases, such as Malaysia, Indonesia and Chile where good institutions enabled channeling resources to their most productive uses (Joya, 2015).

Investing in human capital is an essential ingredient underpinning the diversification process that demands more than the human capital required to generate the easy oil-growth. Oil-rich countries need to adapt their human capital to the new diversification requirements, and this is possible only in proper institutional and governance-related frameworks that make oil revenues immune from corrupt practices. The development of human capital capabilities enables the diversification process to generate greater employment opportunities and enhance growth prospects (Al-Rawashdeh et al, 2013). In fact, economic diversification is facilitated when institutions provide endless possibilities of better quality education that produces high skilled workers. A good education system responds to the labor market's demand for educated workers and thus enhances the oil-rich country's capacity to implement successful economic diversification. Education can bolster people's confidence and capacity to claim their rights and demand things. Educated people know that oil rents are economically not sustainable and hence they can play a role, raise their voices, and contribute to economic diversification in their countries. There is increasing evidence that poor governance in its various forms, especially corruption, inefficient management of public resources and lack of accountability, is the true root cause of inadequate good-quality educational provision. Therefore, export diversification strategies that are aimed at hedging against oil curse cannot be materialized in the absence of good governance practices. Many oil-rich countries have set many diversification goals that are etched in granite and never changed or updated in poor institutional environments which in turn rendered all those goals unrealistic, unclear, vague, immeasurable, uninspiring and unachievable (Albassam, 2015).

Much needed economic diversification processes in many oil-rich countries were either postponed or blocked because groups interested in keeping the status quo were politically stronger than those advocating reforms, rendering these countries financially underdeveloped, economically fragile and crisis prone (Bhattacharyya and Hodler, 2014; Weinthal and Luong, 2006). The shift from productive activities to unproductive rent seeking, or vice-versa, depends greatly on profitability and risk, which in turn relies on the enabling business environment backed by strong institutions and governance (Ongba, 2015). Karshenas and Hakimian (2005) stated that export diversification actually depends on private investment, both domestic and foreign, that is highly reliant on institutional quality. What matters most to investors is the existing governance quality as captured by corruption, law and order, democratic accountability, and bureaucratic quality. Weak governance hampers an oil-rich country's ability to attract investment by lowering the required rate of return on investment projects, exacerbating uncertainty and leading to a colossal misallocation of investment across sectors. Bad governance, however, contributes to the depletion of natural resources and

degradation of the environment and directly targets the poorest and the most vulnerable segments of the society. Governments of oil-rich countries came under considerable pressure to implement governance reforms that would enhance the quality of policy formulation and implementation, encourage economic efficiency, help design better ways to use oil wealth wisely and improve the credibility of political promises. Good governance promotes a healthy and favorable business environment in which non-oil sectors can develop, flourish and make major contributions to export receipts and national economies (OECD/United Nations, 2011).

Iimi (2007) concluded that the degree of which natural resources affect economic diversification depends on the level of governance. First, voice and accountability prevent resource rent from being dissipated, mainly through holding those in authority strictly accountable for their actions. Therefore, the diversification process can be initiated and guided by a steady pursuit of the public good, not the private interests of the rulers. Second, government effectiveness increases pressure on public service providers to deliver quality public services, enhances the capacity and skills of civil servants, and enables the government to produce and expeditiously implement good resource management policies in line with diversification requirements. Third, regulatory quality encourages oil-rich governments to pursue market-friendly policies and remove onerous regulatory burdens holding back economic diversification and growth. Fourth, control of corruption enables oil-rich governments to equitably distribute the wealth that is derived from oil production. Controlling corruption creates the space for the redistribution of oil wealth in the form of economic diversification. Strengthening the grip on corruption deters actions that are economically irrational and prevents selfish elites from serving their own narrow interests. Certainly there cannot be any wide-ranging economic reforms without implementing vigorous anti-corruption policies. A necessary condition for promoting diversification is the pre-existence of a stable political system which is able to control corruption. Iimi (2007) stressed that these four pillars of good governance support diversification away from oil-related industries and harness oil revenues to serve diversification purposes. In general, the quality of governance determines whether large oil endowment turns out to be a boon or a bane for oil-rich countries.

The impact of good governance on economic diversification has received a great deal of attention in recent years. Clark et al. (2016) examine the role of worldwide governance indicators in the different stages of diversification in 29 African countries for the 1963–2009 period using an OLS regression. They find that political stability, regulatory quality and control of corruption greatly matter in all stages of economic diversification. They also confirm that weak governance indicators, especially political instability, poor regulatory quality and corruption, serve as obstacles to economic diversification. Hendrix (2017) empirically explores the effect of governance on diversification for a sample of 40 oil- and gas-dependent economies during the period 2002–2012. OLS estimation provides evidence that governance clearly matters and is positively associated with greater GDP diversification away from oil and gas. Osakwe et al. (2018) find that good quality institutions positively influenced the diversification prospects in developing and Sub-Saharan African (SSA) countries over the period 1970–2010 by applying OLS and General Method of Moments (GMM) techniques. Nguyen et al. (2019) analyze 33 Emerging Markets for the period 2002–

2013 by applying a classical GMM estimation method and find that markets with better institutions, notably government effectiveness, rule of law, regulatory quality, and control of corruption, offer more opportunities for economic diversification. Ross (2019) shows that successful economic diversification is broadly associated with lower levels of oil wealth, greater government effectiveness and high democratic accountability in the 38 largest oil producers between 1962 and 2010. He also asserts that heightened concentration does not necessarily signal poor policymaking because some well-governed oil-rich countries like Norway, Canada and Malaysia, also experienced high concentration during the 1998–2010 price boom.

Furthermore, Omgba (2014) offers a new explanation for success and failure in export diversification patterns in a sample of 34 oil-producing countries (all the members of OPEC and beyond) over the period 1995–2011 using the OLS method. He emphasizes that the period between the date of the beginning of oil production and the date of a country's independence is positively linked with export diversification. He adds that four of the six indicators of institutional quality, namely rule of law, government effectiveness, regulatory quality, and voice and accountability can be improved during a long period. Abdulahi et al. (2019) explore whether the quality of institutions helps alleviate the resource curse in 14 resource-rich countries of sub-Saharan Africa (SSA) from 1998 to 2016 by applying OLS and GMM methods. They use the rule of law as a threshold variable and provide evidence that below the threshold level of -1.37, the resource curse starts to operate, frustrating economic growth. Alsharif et al. (2017) track non-oil export shares of 35 oil-rich countries over the period 1962–2012, using the panel OLS method. Their findings suggest that there are a strong negative correlation between oil dependency and diversification. Makhoul et al. (2015) conclude that effective governance and the type of political regime determine the effect of openness on export diversification. This effect appears to be positive in good governance frameworks in 116 countries during the 1970 to 2005 period. Boschma and Capone (2015) emphasize that the existence of an overarching institutional framework gave 23 developed countries more freedom to jump-start the process of diversification and industrial development by running an OLS regression from 1995 to 2010.

3. Economic Diversification in MENA Oil Exporters

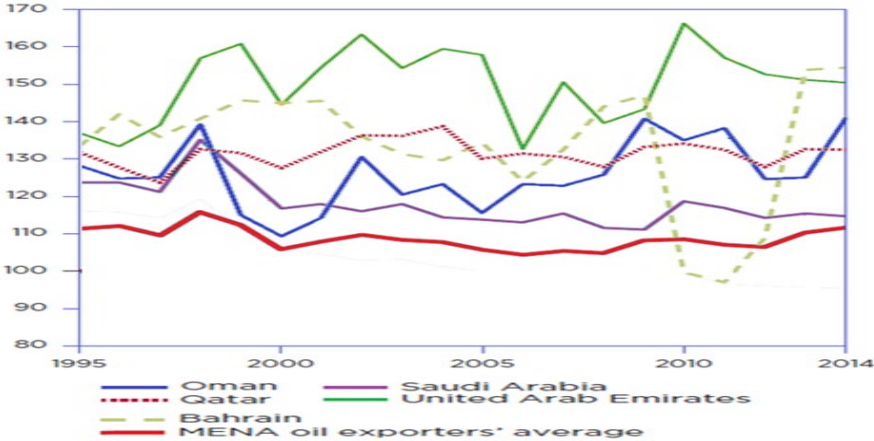
The key goals of diversification strategies have undergone some major changes throughout the years in MENA oil exporters. For instance, a growing focus on economic diversification has been increasingly compelled to respond to oil depletion since the 1970s. As a result of highly volatile oil prices in the 1990s, a new focus on coping with oil rents volatility has emerged globally. Since the beginning of the 2011 Arab uprisings, rising unemployment rates have become worrying. Recently, there has been much concern over the US shale revolution and the potential future decrease in demand for fossil fuels due to environmental degradation (Mazarei, 2019).

Oil abundant MENA countries have achieved some diversification in their services exports baskets, but progress in enhancing the diversification of goods exports has been unsteady, very slow, and very limited since the early eighties. Oil-abundant MENA countries have

prompted their participation in global value chains, but in fact they basically participate as intermediate-good producers instead of final-good producers. These two 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. Failures in accomplishing these goals will eventually contribute to disruption, spur social discontent, cause conflicts, and generate mass migration.

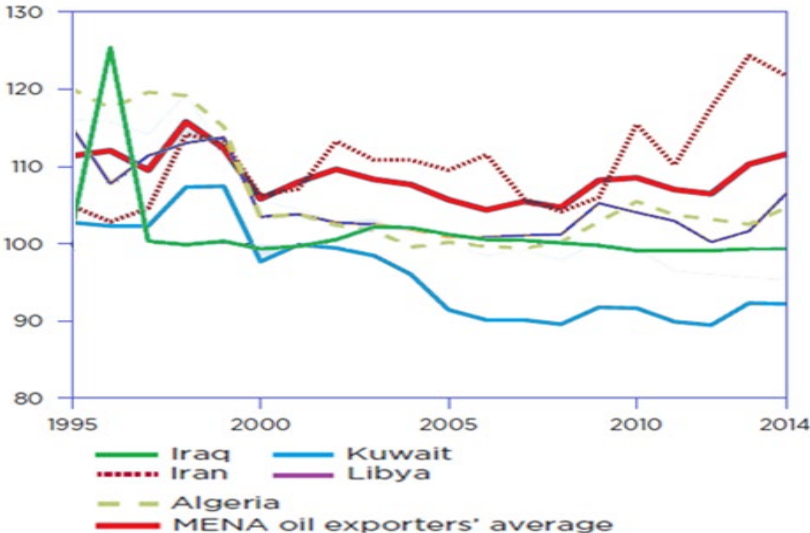
Patterns of Goods Export Diversification in MENA Oil Exporters

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



Inverse Theil index, in real terms (1995 = 110)
 Source: IMF, *The Diversification Toolkit: Export Diversification and Quality Databases*, <https://www.imf.org/external/np/res/dfidimf/diversification.htm> (accessed 28/10/2019).

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).

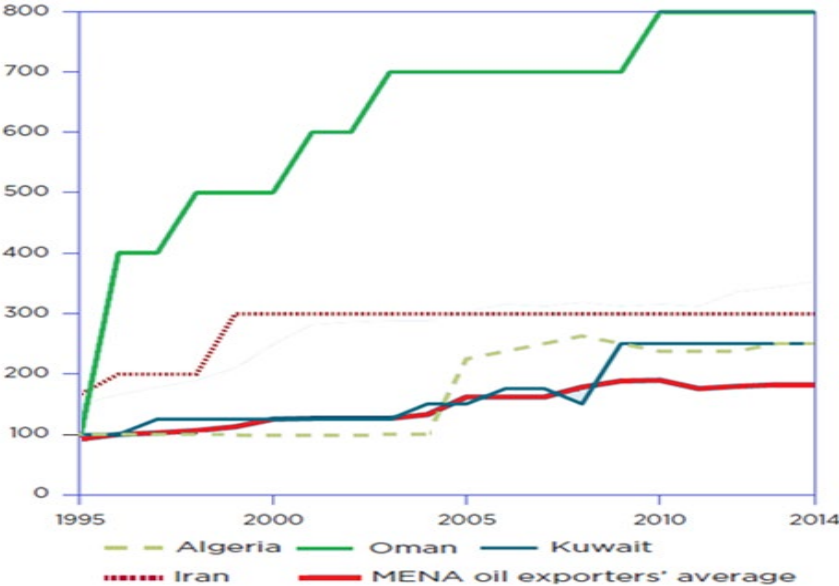
The inverse of concentration indicators is a common measure of export diversification evaluation. These indicators show that there is a slight improvement in goods export diversification over the period 1995-2014. According to data from the IMF Diversification Toolkit, MENA oil exporters have made limited and sluggish progress in enhancing goods export diversification.

Overall, oil-rich MENA countries performed better than their peers over the period 2000-2014. It's worthwhile to note that this progress can be unambiguously attributed to the sluggish diversification in the above mentioned group of countries rather than to the efforts made by MENA oil producers (Mazarei, 2019).

GCC member countries, especially UAE, Oman, and Qatar have made major strides in diversifying their export base relative to the comparator countries. For example, UAE exports gold items, diamonds, pearls, precious metals, other types of jewelry, electrical machinery, equipment, and mechanical appliances; Oman exports auto spare parts; Qatar exports arms and ammunition, parts and accessories. Among non-GCC MENA oil exporters, Algeria and Libya have slightly enhanced their performance in terms of goods export diversification prior to the onset of civil unrest and war; while Iraq, Kuwait, and Yemen did not achieve the slightest progress towards the long-held goal of export diversification, rather they experienced a decline compared to the averages of both MENA oil exporters and comparator countries.

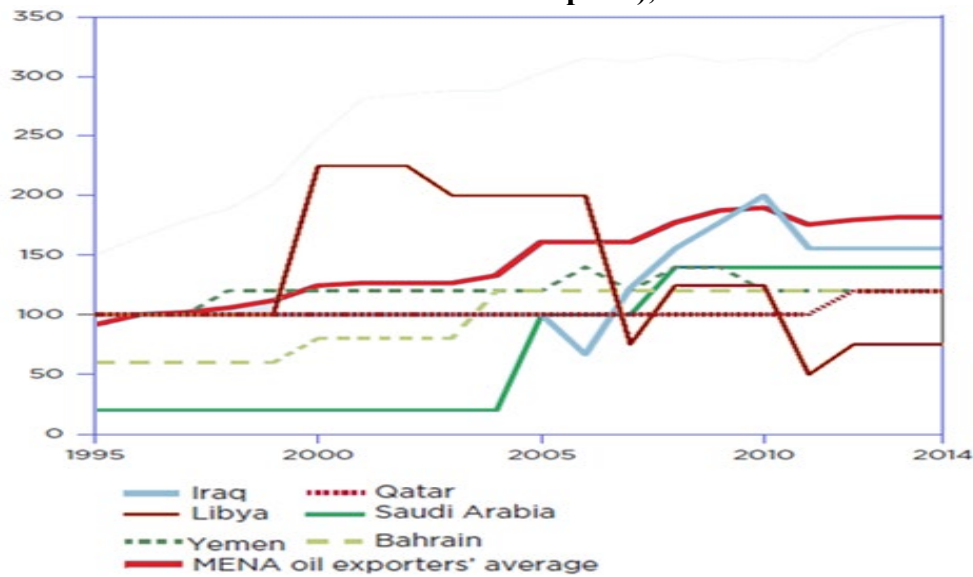
Patterns of Services Export Diversification in MENA Oil Exporters

Figure 3. Diversification of Services Exports by MENA Oil Exporters (Above-Average Diversification of Services Exports), 1995–2014



Number of services categories exported (1995 = 100)
Source: IMF Trade in Services database, 2017.

Figure 4. Diversification of Services Exports by MENA Oil Exporters (Below-Average Diversification of Services Exports), 1995–2014



Number of services categories exported (1995 = 98)

Source: IMF Trade in Services database, 2017.

The situation is different for the diversification of services exports that is eight times greater than that of goods exports due to broad categories of services that are exported from oil-rich MENA countries. It's worthwhile to note that MENA oil exporters achieved an increase of 80 percent in the diversification of their exported services categories from 1995 to 2014. Services export diversification has improved partly due to the increasing range of services recently delivered by oil-rich MENA countries, and it's important to note that services exports are less restricted by regulations compared to goods exports (Mazarei, 2019).

In spite of the fact that the pace of services export diversification was greater than that of goods export diversification, it was confined to a few domains. MENA oil exporters have recorded underperformance in terms of exports diversification relative to comparator countries that have a three times greater diversification of services exports.

The UAE is the most successful economy in terms of services export diversification across the whole MENA region mainly due to its developed logistics facilities and transportation hubs. The UAE has one of the most efficient logistics corridors in the world, for example Dubai Logistics Corridor, Al Maktoum International airport and Dubai's Jebel Ali Free Zone (Jafza) are successfully linking Asia and Africa and enhancing the exports and re-exports of services (Saidi and Prasad, 2018).

MENA Oil Exporters' Participation in Global Value Chains (GVCs)

Oil-exporting MENA economies have increased their participation in global value chains over the period 1990-2013, but their markets didn't climb higher in global value chains as other parts of the world did. It's worthwhile to note that global value chain participation index often measures the depth of a country's participation in GVCs; it is calculated as a percentage of gross exports. It has two components: the forward participation (the share of exports used as

imported inputs of other countries' exports) and the backward participation (foreign value added in domestic exports). This index can determine countries' position in the upstream and downstream segments of the global value chain; a country can be upstream or downstream. This index is constructed in such a way that countries with a larger position index are relatively more upstream, in other words their contribution to other countries' exports exceeds the contribution of other countries to theirs (Aslam, Novta, and Rodriguez-Bastos, 2017).

In fact, Oil-exporting MENA countries modified their participation patterns in global value chains by boosting their forward participation mainly through increasing their value added in other countries' exports; while many ASEAN countries enhanced their backward participation in GVCs mainly through increasing their use of other countries' exports in their export production, and the most common example is importing foreign inputs and using them in producing automobiles and assembling computers. For instance, Algeria has taken steps to improve its automotive industry in an effort to effectively participate in nonoil global value chains. Algeria's vehicle-assembly industry was relying on EU inputs. Algeria is now trying to shift the focus towards local manufacturing of vehicle components for serving both domestic and export markets, that's why leading global companies in the automotive sector have shown a growing interest in Algeria as a hub for automobile components and parts.

Structural Reforms and Management of Oil Revenues in MENA Oil Exporters

MENA oil producers have sought to diversify their economies and move away from oil dependency. The strategies pursued so far have yielded mixed results. More attention has been paid to state-centered industrial policies and private sector development. The UAE has been successful in diversifying its economy by pursuing vertical and horizontal diversification strategies. For instance, Abu Dhabi enhanced vertical diversification in hydrocarbon sector, while Dubai focused on horizontal diversification in existing sectors. GCC governments are using their sovereign wealth funds (SWFs) as investment vehicles to strengthen economic diversification process and build resilience against future economic shocks and oil price collapse. There have been also too many failed attempts at economic diversification in several oil-exporting MENA countries where substantial public resources were wasted through extravagant import-substitution projects (Mazarei, 2019).

The sharp fall in oil prices since June 2014 has brought economic diversification and structural reforms to the forefront of oil-rich MENA governments' concern. Economic diversification is a key target in these countries' sustainable development plans. For example, Saudi Arabia has released keenly awaited and ambitious plans to diversify their revenue streams. Vision 2030 charts out the path Saudi Arabia will take to diversify its economy away from oil dependence. This vision targets:

- Raising the private sector's contribution to GDP from 40% to 65%
- Increasing the proportion of non-oil exports from 16% to 50% of the GDP
- Increasing SMEs contribution to GDP from 20% to 35%
- Raising non-oil government revenues from 43 billion USD to 267 billion USD by 2030

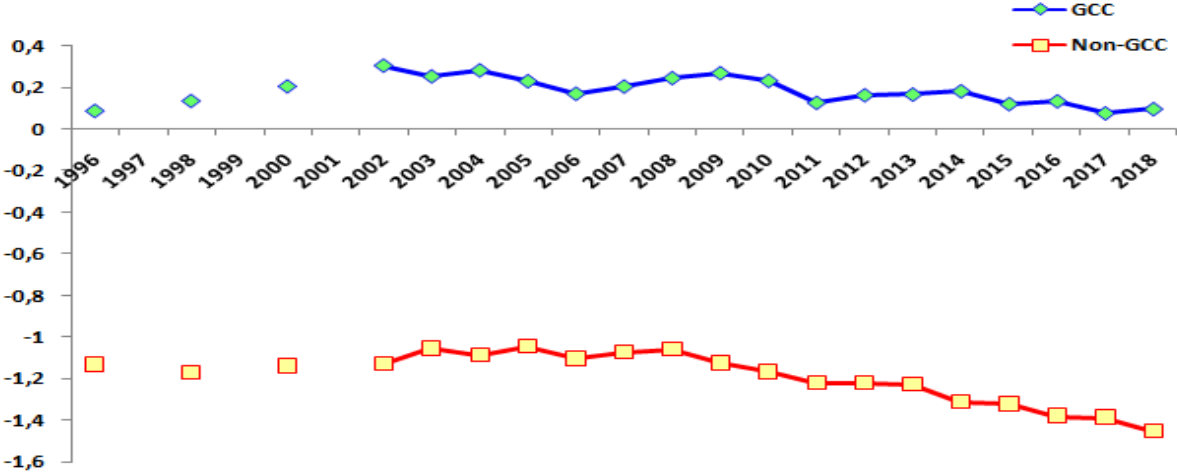
- Lowering the rate of unemployment from 11.6% to 7%
- Increasing FDI from 3.8 percent of GDP to the international benchmark level of 5.7 percent of GDP by 2030, and
- Increasing the capital of its public investment fund from 160 billion USD to 2 trillion USD by 2030.

Perhaps vision 2030 is over-ambitious and that’s what will probably make it falter or fail. Saudi Arabia has formally put on hold the initial public offering of Aramco (Saudi Arabia's giant state-owned oil company) in the second half of 2018. Successful visions are based on reliable information, applicability and presence of accompanying political reform, many of these elements are lacking in vision 2030 which seems easier said than done (El-Gamal, 2016; Fattouh and Sen, 2016; Kinninmont, 2017).

Overall, the limited diversification of MENA oil-exporting economies underlines the need for radically rethinking economic diversification policies. These governments must first address governance issues, institutional weaknesses, structural flaws, misguided employment policies, and constraints to private sector development (Arezki et al. 2018).

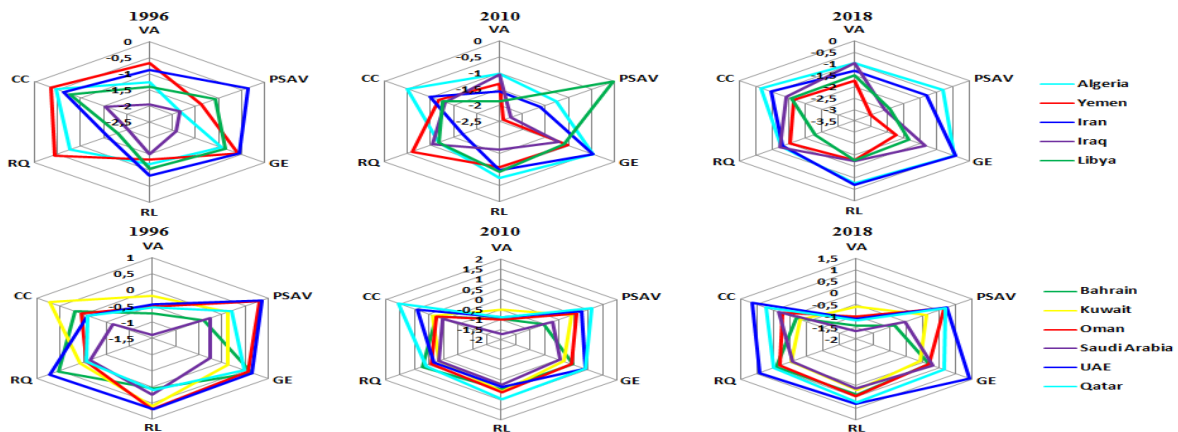
4. Good Governance in MENA Oil Exporters

Figure 5. Governance Index (The Simple Average of Six Worldwide Governance Indicators) in Oil-Abundant MENA Countries, 1996-2018.



Source: World Bank Governance Indicators, the data are available online at: <http://info.worldbank.org/governance/wgi/index.asp> (accessed 28/10/2019).

Figure 6. Governance Indicators in Oil-Abundant MENA Countries, 1996, 2010, 2018.



Source: World Bank Governance Indicators, the data are available online at: <http://info.worldbank.org/governance/wgi/index.asp> (accessed 28/10/2019).

GCC countries continue to dominate the top tier of good governance score, while non-GCC MENA oil exporters have consistently scored quite low on governance (Figure 5). Most MENA oil exporters suffer from poor governance at multiple levels, including serious loopholes in public administration, poorly performing public services, stifled political freedoms, the absence of rule of law, harshly restricted civil liberties, poor human rights records, unenforceable legislations, and archaic laws and regulations. These factors undermined diversification attempts which all turn into dead ends in oil-rich MENA countries. More importantly, what good-governance promise do MENA oil exporters hold as a potential route out of oil dependency?

Voice and Accountability

Most oil-exporting MENA countries score poorly on measures of voice and accountability (Figure 6). They also earned the lowest scores in the world, especially Saudi Arabia and Libya. There are glaring weaknesses in institutions of accountability in these countries, where oil revenues go directly from oil companies to the state budget without obtaining feedback from citizens. Thus, citizens don't know how much oil revenues their governments receive. Many don't even realize it's their money. As a result, these governments are not held accountable for how oil rents are spent. It is, then, not surprising to hear that the extent of leakage and corruption taking place at various levels is unbelievably high (Devarajan, 2018). Most MENA oil Exporters show no willingness to demonstrate accountability, it was expected, because when one country restrict accountability, others in the neighborhood follow.

The accountability deficit in oil-exporting MENA countries can be explained by the Arab world's democracy deficit which has enabled dictators to maintain their iron grip on power for decades unchallenged. According to Bellin (2012) and Hinnebusch (2006) citizens of all oil-rich MENA countries cannot freely express their economic and political grievances, which are mainly caused by broader democratic shortfalls, pervasive governmental corruption, limited political participation, non-credible and inefficient judicial systems, abuses of power, and

violent breaches of human rights standards. All MENA oil producers are characterized by long-established autocratic regimes and have a long history of weak government performance and authoritarian clientelism that violated fundamental democratic principles and muted the calls for accountability and transparency. The lack of adequate checks and balances in oil-rich MENA countries create possibilities for abuse of power, and hence public officials are not typically held publically accountable for performance failure. These accountability shortcomings are making citizens feel they do not have the power to make change by themselves. Thus, the lack of accountability of politicians to the public at large seems one of the obvious reasons for failed economic diversification. Nonexistent or poorly performing accountability mechanisms often translate into bad economic decisions, irrational policy preferences, deficiencies in policy-making, and ultimately, low levels of economic diversification combined with high levels of dependence on oil.

Political Stability

What raises concern is that political stability was low for all non-GCC oil rich countries with a decreasing trend, indicating that these countries are experiencing a political and economical unstable situation.

The tide of the Arab Spring revolutions that have swept most Arab countries since 2011 came as a result of a history of absolutism and a shared discontent with the corruption of Arab rulers. The 2011 Arab revolutions that are best described as uprisings for democracy and dignity has not only affected long established structures in the Middle East, but has also brought economic contraction to the states most affected by the Arab Spring. Arab uprisings showed that the Arab social contract started to unravel and brought the need for a new contract between citizens and states to the forefront. It's worthwhile to note that a vital private sector is an essential ingredient in the efforts of oil-rich MENA countries to draw a new social contract. Most obvious is the need for political stability, to allow more private sector participation. When conditions become sufficiently attractive (political stability that makes it easier for private companies to make a predictable profit), the private sector thrives.

To be sure, forecasting future events in MENA oil exporters is usually a fool's errand. Looking further ahead, there are some key issues to be watched closely. Since 2014, Yemen has been engaged in a civil war that is becoming even more complex. At least 70,000 people have been killed in Yemen's war to date. This war is unlikely to end anytime soon. The civil war in Libya between government-allied western militias and Libyan National Army is escalating and keeps on drawing in foreign powers. At the time of writing, fighting is ongoing and will likely result in further radicalization. Libya finds itself facing an unprecedented economic crisis, as the battle for oil wealth is set to intensify. Oil output disruption in Libya greatly counts on how the fighting around the capital Tripoli evolves. Iraq has suffered from decades of civil war, conflicts and political instability. In 2018, Iraq produced oil at record levels and is forecasted to boost production to 5 million bpd by 2028. The Trump administration unleashed its toughest ever sanctions against Iran and choke off the last remaining sources of Tehran's oil revenue. As a result, stringent U.S. sanctions have had

profound crippling effects on the Iranian economy, and the impact of these sanctions is dragging on the broader region's activity.

The deep division within the Gulf Cooperation Council (GCC) as the blockade of Qatar enters its third year. This crisis certainly negatively affected the GCC at first. So far, efforts to resolve the most serious dispute to date within the GCC have failed. GCC countries need to overcome this rift and end their dispute. Much more needs to be done to resolve this complex and deep-rooted conflict.

All these conflicts, disputes, and tensions exacerbate political instability and distract governments from vital domestic reforms and hence cripple economic diversification efforts.

Government Effectiveness

Non-GCC MENA countries on average performs slightly worse than GCC comparators especially the UAE, Qatar, Bahrain and Oman, as measured by the government effectiveness indicator (Figure 6). However, the WGI government effectiveness indicator shows a clear upward trend with some fluctuations for GCC countries and is the best score for MENA oil exporters among all governance indicators. GCC countries have specified quite similar targets for their public sector's modernization. While non-GCC MENA oil exporters have not been as successful as their GCC comparators in providing higher quality public services, and instead have made no efforts to downsize bloated and inefficient bureaucracies. Previously, the shift to the state-led model of development induced MENA oil exporters to create an inefficient, expensive and oppressive bureaucracy (Al-Hegelan and Palmer, 1985). This bureaucracy system was ill-equipped to handle the fast-changing requirements, cope with the oil dependency problem and carry out the daunting responsibility of economic diversification. Lack of quality education and skills training made most employees and top echelons unable to carry out their duties with competence and effectiveness. Accordingly, oil MENA governments proceeded to adopt wholesale Western methods to modernize their bureaucracies by inviting foreign experts to find ways of improving administrative quality stepwise and sending their public servants overseas to train in the best institutions. Non-GCC oil MENA governments realized that neither their administrative reform efforts had been successful nor had their hopes to deliver improved public services and make faster tangible progress been satisfied (Jreisat, 1997). Bureaucracy has become merely an instrument of domination in the hands of bureaucrats who constituted a new exploitative class (Ayubi, 1986). Government departments become market places for corruption, bribery, favoritism and nepotism, laziness, and inflexibility, and their practices seem cumbersome and outdated. Removing unnecessary bureaucracy will allow Non-GCC oil MENA governments to sidestep arduous processes and amend defective arrangements. This failure must bring into question these governments' commitment to reforms. On the one hand, most Arab citizens blame their governments for unfulfilled goals, and on the other hand public servants are being accused of corruption or incompetence, or both by their governments. Whoever is responsible, public sector management reform is one of the key elements to reinvigorating these stagnating economies that have been missing out on the benefits of economic diversification.

Providing services by using digital technology is perceived to increase government efficiency, effectiveness, and transparency, and reduce costs of government delivery. In most cases, Arab public bureaucracies do not want to adopt and adapt to digital technologies because they find it hard to capture the rents from government procedures in highly transparent frameworks supported by the use of digital technologies. There are also cases where bureaucracies may not be able to adapt quickly to new technologies due to the lack of infrastructure support. Another concern arises from the effects of new technologies on the centralization of information (Devarajan, 2019). Thus, enhancing government effectiveness depends on the way in which new technologies are adapted, and it is preferable to hold a part of information at the local level and the other part at the central level.

Regulatory Quality

Regulatory quality varies across oil-exporting MENA Countries. The GCC countries are approaching developed country standards in regulatory quality (Figure 6). While, non-GCC MENA oil exporters had lower scores, which means that their regulatory quality is extremely poor. Regulatory quality is one of the most important governance factors for economic diversification. An important feature of this index is that it is more focused on market-friendly policies that provide a wholly supportive environment for nurturing the development of private sector (Kaufmann et al., 2006). Oil-exporting MENA governments realize that efforts to improve regulatory quality are a central part of governance reform. Worse, non-GCC MENA oil exporters didn't ensure good regulatory quality, and that's what makes it easier for these governments to pursue market-unfriendly policies and maintain unnecessary regulatory burdens, thus preventing economic diversification efforts and crippling governance reforms. These countries urgently need to address regulatory institutions and practices that are outdated and ineffectively managed in order to catch up with GCC countries which supported regulatory institutions and ensured that proper legal and regulatory mechanisms are put in place. It's worthwhile to note that regulatory reform is greatly supported by high quality competition law and institutions. Non-GCC MENA oil exporters do not currently have in place effective domestic competition laws and policies; they have not sustained a clear commitment to business regulation reform. There is a growing consensus that economic diversification is more likely to be promoted when the cost of doing business remains low, but this cost is very high in non-GCC MENA oil-rich countries mainly due to excessive and unpredictable regulation. The annual 'Doing Business' 2019 report of World Bank mentions that Algeria, Iraq, Iran and Libya failed to reduce the costs of doing business; it is still very difficult for local entrepreneurs to start and run small and medium-size businesses when complying with relevant regulations. GCC countries are far ahead of the rest of the region in terms of doing business due to sound regulations put in place to safeguard economic activity and facilitate business operations. The achievement gap between GCC and non GCC MENA oil exporters in terms of doing business is mainly caused by regulatory issues, particularly those relating to tremendous bureaucratic hurdles, the difficulty of obtaining construction permits that takes longer than the actual construction, and the inability to enforce contracts. In short, good regulatory quality is one pillar of economic diversification. Hence, non-GCC

MENA oil-exporting governments must achieve the right balance between reducing unnecessary and costly regulatory burdens and achieving regulatory predictability.

Rule of Law

There is a fundamental deficit of the rule of law, albeit at varying degree across oil-abundant MENA countries. It is fair to say that the record of MENA oil exporters has been mixed, as shown in Figure 6. The GCC countries have made good progress toward establishing the rule of law, while non-GCC MENA oil exporters have consistently scored quite low on the rule of law (Figure 6). The leaders of oil-rich MENA countries must do far more to establish the rule of law. MENA oil exporting countries' rule of law needs to be strengthened especially in terms of the protection of property. Key features of weak rule of law in non-GCC oil-rich MENA countries are inefficient judicial administration, dependent judiciary, lack of legal accountability, unaccountable judges, unfair justice system, and inaccessible, unpredictable, and slow legal systems. Most governments of non-GCC oil-rich MENA countries do not apply fair and equitable laws equally and consistently to all of its citizens. The consensus seems to be that these countries deserve low score on rule of law because their governments failed spectacularly in four aspects of rule of law; firstly, they failed to control violence, enforce humanitarian law and provide personal security to their populations; secondly, they failed to provide adequate protection for property and enforce contractual rights; thirdly, they kept bad political institutions that lack strong checks and balances on the abuse of power; and finally, they failed to fight against bribery and corruption. Efforts at economic diversification are less likely to materialize when national rule of law systems are often incomplete or broken.

Indeed, GCC countries have strengthened their legal infrastructure, addressed the weaknesses in contract enforcement, placed great emphasis on the protection of intellectual property rights, and improved the efficiency of commercial courts (Looney, 2013). The strengthening of traffic law enforcement in GCC countries has maintained public confidence in the rule of law because it has significantly reduced the incidence of crime and violence in the Arabian Gulf communities. Despite the later improvements that were made, GCC governments seem to overlook the most important elements of political governance which must be urgently addressed within the rule of law indicator. For example, although Qatar obtained high scores in rule of law and ranked first in the region, the watchdog group Freedom House designates the Qatari judicial system "not independent in practice". Although the Qatari constitution prohibits arbitrary arrest and detention, there were complaints that a 2002 law allows the suspension of these guarantees for "the protection of society" (Freedom House, 2011). This kind of progress entails high risks of failure because it will be difficult or even impossible for GCC countries to sustain their progress in the future by introducing the necessary political reform without having the will to implement reform. Most GCC governments continue to believe that the establishment of rule of law and its maintenance are not necessarily limited to democratic countries (Ungar, 2002). In general, economic diversification can only exist in countries where the rule of law exists, as rule of law institutions with efficient justice are the main instruments that protect property rights and enforce contracts and hence promote

economic stability that greatly enables oil-rich MENA countries to diversify their economies and export bases.

Control of Corruption

To add to the grim picture, non-GCC MENA oil exporters have consistently scored quite low on control of corruption (Figure 6). Yemen and Libya rank in the bottom 10% of MENA oil exporters, displaying the lowest levels of control of corruption. They are facing an alarming variety of problems such as chronic instability, immense human suffering, war, conflict, displacement and terrorism, to remain at the bottom of the index. Similarly, Iraq has witnessed frequent and persistent waves of corruption that led to the draining of its treasury and wasting of the public money, after the 2003 American-led invasion. Successive governments in Algeria have failed to address decades of rampant corruption. This increasingly pervasive corruption has had a disruptive impact on the Algerian economy. The Algerian judiciary launched massive anti-corruption campaign and is pursuing high-level corruption prosecutions since the start of the protests on February 22, 2019.

Nonetheless, some GCC countries, especially the UAE and Qatar fared better than the grim picture painted so far, this has more to do with their higher levels of human development, levels of stateness, efficient and transparent public sector administration, high gross domestic product (GDP), and significant advances in the areas of health and education. Despite these strengths, UAE and Qatar still lack democratic institutions and restrict many political rights. This leaves control of corruption dependent largely on the political will of the incumbent ruling elite, which can be replaced by a new one at any time, and hence improvements in anti-corruption efforts may be left behind. According to the leading anti-corruption group Transparency International, Dubai is classified as an active global hub for money laundering and a haven for shady characters due to its unrestricted luxury real estate market and notoriously secretive banking system.

Simply speaking, the rules are broken, and government corruption prevails, when democracy consciousness is lacking among people. In MENA oil exporters where democratization proves impossible, civil liberties are restricted, and the old social contract between the people and the regime has expired, it is unsurprising that the extent of corruption remains stubbornly high. Corruption remains the major challenge for oil-exporting MENA countries where bureaucratic bottlenecks still persist, despite public commitments by governments to root out corruption, increase transparency and strengthen the play of market forces. This is partly due to corrupt actors who are actively frustrating reform efforts, intruding into politically-sensitive areas, and unfortunately, exerting a good deal of indirect influence on the decisions of leaders. When democratic control is established and preserved, checks and balances limit how much control the government branches can have. Checks and balances are among the most efficient anti-corruption institutions. Unfortunately, many MENA oil exporters lack the right institutional checks and balances, which are necessary to maintain a separation of powers. Oil-rich MENA countries need a distinctively different design that gives primary importance to checks and balances. In many oil-abundant MENA countries, powerful individuals have quite a profound impact on the exercise of state power. More dangerously, they diverted

public funds toward their private accounts and enriched themselves at the expense of the people. This ensured that anti-corruption efforts are no more than ink on paper, where a good part of the laws passed was not meant to be implemented. Insofar as corrupt politicians and bureaucrats sabotage anti-corruption initiatives and intentionally disregard their sworn duty, oil dependency is inevitable in most oil-rich MENA countries.

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

Most MENA oil exporters seem incapable of reversing a growing economic deterioration despite growing oil exports. To put this in perspective, it is useful to contrast oil-rich MENA countries' experience with that of Malaysia, Canada and Norway, which shares some characteristics with MENA oil exporters but have successfully managed to escape the oil curse.

Malaysia

Malaysia is an oil-rich country that had avoided the resource curse trap and used its abundance of natural resources as a stepping stone toward a new stage of development and economic prosperity. Malaysia posted impressive growth rates and per capita income gains from the 1970s right through to the 1990s, becoming an upper middle income country and reducing the poverty rate from 49% to less than 5% in 2007. This progress was made possible through transformative and farsighted leadership, market-friendly policies complemented with macroeconomic stability, openness to the global economy, access to large FDI inflows, and high rates of saving and capital investment. These are major reasons why significant export diversification is taking place in Malaysia.

Malaysia has now become a more diversified, modern and open economy, with a trade to GDP ratio averaging over 130% since 2010. It has significantly diversified its export products. The share of manufacturing exports has rapidly increased to 70% of the total Malaysian exports in 2009. Oil only accounted for about 10 percent of Malaysia's total exports that year. Malaysia's electronics industry also accounts for 45 percent of total exports. The biggest target markets for Malaysia's electrical and electronics industries are the US and Europe. At the same time, infrastructure and other social outcomes also diverge significantly between Non-GCC MENA oil exporters and Malaysia. About 85 percent of roads in Malaysia are paved. Malaysia has extensive transport and communications networks throughout the country. Hardcore poverty was totally eliminated in Malaysia. These economic and social outcomes are strongly linked to political institutions and long-term oil revenue management strategies implemented in Malaysia.

According to Collier (2010) Malaysia has succeeded in fundamentally diversifying its economy and switching over to higher value-added products mainly due to its honest leaders and public officials with a sense of national purpose. The more successful development outcomes have been those shaped by Malaysian political leaders whose ideas were forged in strengthening the Malaysian economy and delinking it from heavy reliance on oil revenues.

Most importantly, the link between oil and Malaysian economy cannot be understood outside the realm of political economy. Malaysian political institutions (especially federalism) constitute an important ingredient for successful diversification and, eventually, industrialization. Malaysia's federal system and robust democracy forced political parties to solve the major problems facing voters. Tun Dr Lim Chong Eu, the father of modern Penang and Penang's Chief Minister for over 20 years, revived the state's economy after it lost its free port status in 1967. He made Penang as a manufacturing production success story by envisaging it as the production base for international electronic firms in 1970. He also implemented the Free Trade Zone concept in Penang in 1971. This successful experience coupled with rich insights was subsequently replicated in other parts of Malaysia. Mahathir Mohamad, the Prime Minister of Malaysia from 1981 to 2003, often portrayed as a reformer and modernizer who greatly influenced economic policy and industrialization in Malaysia (Alsharif et al., 2017).

Malaysia's institutional setting starkly contrasts with that of most MENA oil exporters, where most political powers are highly centralized at the national level and in presidential hands. Malaysia's institutional tissue enables prudent management of oil revenues. Malaysia's national oil company, Petronas, was created in 1974 and was given a central role in production and in negotiation of technology transfer from multinational corporations. Petronas has accumulated enough know-how, experience, and capital and hence has succeeded in ventures abroad and tapped growth outside its saturated domestic market in less than four decades. This was possible due to full transparency in the Malaysian oil sector and accountability which is enhanced through publicly available information on Petronas' profits, oil revenues collected by the Malaysian federal government and direct and indirect taxes from the petroleum sector. In general, Malaysia's institutions ensured government transparency and accountability and naturally laid the ground for economic diversification.

Canada

Canada has the third largest oil reserves in the world after Venezuela and Saudi Arabia and is the fourth largest producer and exporter of oil in the world. Despite the abundance of oil that characterizes Canada, oil exports do not exceed 20% of total exports. Canada maintains a large absolute value of exports, it is interesting to know that fuels exports account for less than 20% of Canadian exports, compared with the average of 81 percent for OPEC member countries, emphasizing Canada's highly diversified economic structure. Canada is highly dependent on the U.S. market for its oil exports. In 2013, 97% of Canada's crude oil production was exported to the U.S. and the remaining 2% was exported to overseas markets. Canada accounts for about one third (34 per cent) of all oil imports to the United States. The new challenge facing Canada is to diversify its trade partners, reduce dependence on the U.S. market, and increase its exports to other emerging market countries, especially Asian emerging economies. Eventually, the propensity to spend oil revenues on imports has historically been much lower in Canada compared with MENA oil exporters.

Good institutional quality paved the way for domestic financial development and allowed prudent management of foreign exchange reserves in Canada and hence provided the

necessary conditions for a diversified economy and thriving tradable sectors (Gnimassoun et al., 2017). Countries that acquire the most advanced technology like Canada tend to have more diversified export bundles. Economic diversification policies were favored by Canadian political elites under the influence of good quality institutions, eliciting immunity against the oil curse. Basically, the good Canadian institutional history based on transparency and the rule of law proves why Canada succeeded in diversifying its economy while most oil-exporting MENA countries failed. More specifically, good governance and strong institutions lied at the core of the pre-development of non-oil sectors that made it possible to catalyze the dynamics of diversification in Canada (Djimeu and Omgba, 2019). Alsharif and colleagues (2017) found a positive association between non-oil exports and institutional quality; they also stated that oil-rich countries (such as Canada) with growing non-oil export sectors enjoy strong institutions that in turn help attracting good-quality investment; they added that strong institutions are built and maintained by strong and respected leaders who enforce good governance principles and merit special attention in the diversification process. Canada has successfully increased its government effectiveness without significantly increasing expenditure by virtue of its legal institutions. Typically, the Canadian government ensured transparency, accountability and consultation with interested parties. Accordingly, private entrepreneurship and domestic investment flourished in such a context of good governance.

In fact, Canada stands to benefit from diversifying the composition of its export mix. In 2017, Canada's overseas merchandise and service exports were reported to be around \$190 billion. There are, however, other aspirations and other interests; the Government of Canada intends to increase overseas exports by 50% by 2025. Canada's core governance rules will help achieve this stated goal.

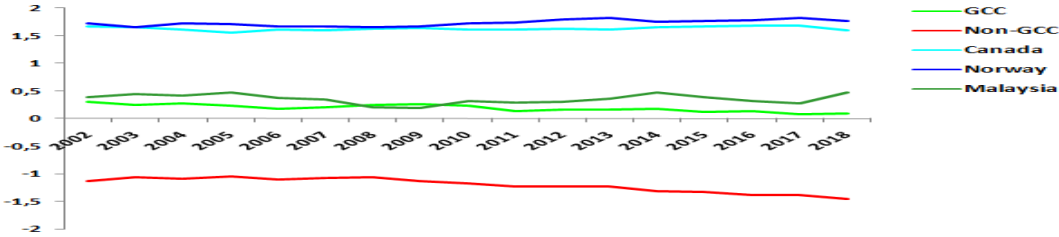
Norway

The Norwegian experience of economic diversification is one of the most inspiring diversification success stories. Norway stands out as an example of an oil-rich country which has successfully managed its oil wealth with a focus on the future. Norway turned a large part of its oil wealth in the ground into financial assets in a sovereign wealth fund (SWF), equivalent to 2.5 times the GDP of Norway and that is considered a unique achievement. The Norwegian oil fund, formally known as the Government Pension Fund Global (GPFG), performs the stabilization and savings functions effectively. It strictly controls annual withdrawals, making Norway an example of a successful case of escaping the resource curse. A mandatory spending cap was proposed as a way to control the spending of revenues entering the fund each year and limit it to 3 percent of the stock of assets in the fund. It's worthwhile to note that the Norwegian Oil Fund has enjoyed a high degree of public trust and legitimacy. Thus, the Norwegian oil fund has developed a prosperous and increasingly diversified economy and become the most important element of the Norwegian government's diversification policies. More importantly, the Norwegian oil fund is designed to put aside oil revenues for future generations in order to promote intergenerational equity. Other oil-rich countries can easily establish a similar oil fund but their ability to manage it over time remains very much in doubt. For example, the diversification gap between Norway and

UAE still has not been closed despite the fact that UAE owns the Abu Dhabi Investment Authority that is the world's third-largest sovereign wealth fund according to the Sovereign Wealth Fund Institute (Kaznacheev, 2017). In large part, it was Norway's institutional sophistication, and specifically high quality of governance and political legitimacy, that allowed the Norwegian government to pursue policies of prudent management of oil fund. Norway wisely used its Oil Fund as a preventive mechanism against the oil curse and Dutch Disease by dint of effective governance and appropriate institutional mechanisms put in place. Therefore, oil-rich countries that lack such good institutions and governance are definitely unable to experience the Norwegian success. Even more impressive than establishing and maintaining one of the world's largest sovereign wealth funds is the way Norway has managed to build a large and strategic industrial sector that supplies goods and services and provide intermediate inputs to the oil industry (Nore, 2019). In fact, Norway's industrial sector is technologically advanced, internationally competitive and highly profitable and it typically contributes 35 per cent to exports. Nore, P. (2019) shared a key takeaway and confirmed that good governance and competent institutions have significantly helped the Norwegian diversification process and have been essential to its huge success.

State oil companies depict the economic strength of an oil-rich country and the performance of those companies depends on the overall institutional environment in which they operate. For example, Norway's Statoil has dominated Norway's brand landscape for years and is the most influential state oil company operating in the North Sea because it is subject to Norway's extensive transparency, financial disclosure and open-government laws (Kaznacheev, 2017). Moreover, Norwegian government realizes that a high per capita income alone is not enough and it must be associated with good quality education that is the most important instrument to ensure good governance and empower citizens to realize their rights and be productive and competitive. But some oil exporters like GCC countries care most about being rich in terms of national income per head. Average GDP per capita in Qatar and UAE rivals that of Norway, but their educational outcomes are on par with upper-middle-income countries like Mexico and Ecuador. Lagging education and training reflect on doing business and therefore GCC countries' ability to diversify away from oil is frustrated (Hendrix, 2017). The World Economic Forum's annual Executive Opinion Survey (2014-2015) cited an “inadequately educated workforce” as one of the biggest challenges in doing business in most GCC countries.

Figure 7. 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).

In the end it is about governance (Figure 7), politics and leadership vision; the wise management of oil revenues reflects the view of Malaysian, Canadian and Norwegian decision makers who desire to promote the well-being of current and future generations and ensure an equitable distribution of oil wealth between them. The pioneering Malaysian, Canadian and Norwegian experiences in economic diversification show MENA oil exporters that they can catch up in their diversification process if they strengthen their institutions and governance practices.

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.

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. Data Analysis Tools

This paper uses a panel data analysis due to its ability to control the impact of heterogeneity (both observed and unobserved), this analysis is also effective in reducing degrees of freedom and addressing collinearity problems, thus producing substantially better results (Hsiao 2003). Besides using the pooled OLS model, fixed effects model and random effects model, the Generalized-Method of-Moments (GMM) dynamic panel estimator proposed by Arellano and Bond (1991) and developed by Arellano and Bover (1995) and Blundell and Bond (1998), is also employed due to its ability to deal with persistent data, neglected endogeneity and heterogeneity issues by using and selecting valid instrumental variables.

C. Analysis of Empirical Results

Table 1. Summary Statistics

	GDP	OILR	DIV	CONC	GI	EF	AGR	IND	SER
Mean	0.667134	30.14898	0.770619	0.628570	-0.440722	58.17644	4.941953	1.33E+09	40.41056
Median	0.594612	28.39604	0.785283	0.615184	-0.330983	62.50000	2.799453	52.18771	41.32889
Maximum	104.6576	68.85125	0.906000	0.982848	0.790014	77.70000	19.56317	9.97E+10	65.35021
Minimum	-62.21435	0.740798	0.522000	0.230000	-1.993695	15.60000	0.092542	21.21598	5.228513
Std. Dev.	10.82929	14.37615	0.074868	0.176688	0.766497	14.19819	4.573226	1.01E+10	10.67498
Skewness	2.809980	0.489151	-1.353486	0.135153	-0.227052	-1.017635	0.839703	8.033984	-0.593357
Kurtosis	44.18627	2.823783	4.997229	2.345013	1.796079	3.480365	2.779250	69.85001	3.722532
Jarque-Bera	17494.91	9.634250	118.8244	5.292687	15.17665	40.99761	19.12758	31514.02	12.54723
Probability	0.000000	0.008090	0.000000	0.070910	0.000506	0.000000	0.000070	0.000000	0.001885
Sum	162.1137	7054.860	194.1960	159.0282	-96.95881	13089.70	790.7126	2.13E+11	6304.047
Sum Sq. Dev.	28380.20	48154.96	1.406913	7.867121	128.6664	45155.83	3325.388	1.62E+22	17663.05
Observations	243	234	252	253	220	225	160	160	156

Source: Author's Computation Using Eviews 8.0.

The Table 1 presents the summary statistics for all variables included in the empirical study, covering 11 oil-abundant MENA countries (Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates, and Yemen) over the period 1996-2018. As can be readily seen from this data, GDP has an average of 0.6671 and a maximum value of 104.65, reflecting that there are certainly large regional differences in growth rates. Also, the average of oil rents is 30.14 and its maximum value is 68.85, indicating that most MENA oil exporters are heavily dependent on oil export revenues. Whilst, the average diversification

index of 0.7706 confirms that the blind reliance on oil remains the economic mainstay of MENA oil-exporting economies; further, this poor diversification is blamed for today's growth in the region. While, governance index (GI) has a mean value of -0.4407, reflecting that the region as a whole performs poorly in terms of governance.

Table 2. Regression Results for 11 Oil-Abundant MENA countries

Dependent Variable: GDP			
Coefficient Estimates			
(P-value)			
Independent Variables	Pooled OLS Model	Fixed Effects Model	Random Effects Model
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.

The Table 2 reports the results of three different estimation techniques: pooled OLS, fixed effects and random effects models. All explanatory variables tend to have statistically significant coefficients with the expected signs in all regression, except the diversification index and governance index that appear to be insignificant in pooled OLS and random effects models, indicating that the triptych diversification-governance-oil rents has a crucial role to play in maintaining sound economic growth. Thus, the choice between fixed and random effects models will be made based on the Hausman test.

Table 3. Hausman Test

Correlated Random Effects - Hausman Test			
Equation: Untitled			
Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	10.946916	3	0.0120

Source: Author's Computation Using Eviews 8.0.

The Hausman chi-square test statistic is statistically significant at the 5% level of significance (Prob (0.0120 < 0.05)) (see Table 3), then the null hypothesis is rejected in favor of the alternative hypothesis, in other words the Hausman test shows that the fixed effects model is the appropriate one, so we focus on it in this empirical study. On this basis, it is concluded that diversification, good governance and oil rents lay the foundation for sustainable growth in MENA oil exporters. In order to examine the main symptoms of the resource curse

phenomenon in oil-abundant MENA countries, we estimated several models as shown in Table 4.

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

Dependent Variable	(a)	(b)	(c)	(d)	(e)	(f)	(g)
	OLS FE	OLS FE	OLS FE	OLS FE	OLS FE	OLS FE	OLS FE
	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.

Results for each of the seven models are presented in the Table 4; MENA oil exporters' growth is greatly and positively influenced by oil rents that can serve as a crucial funding source for many other sectors (see column (a)). The fixed effect OLS regression in column (b) reveals that oil rents exhibit a statistically significant positive effect on economic growth at the 1% level of significance. Industry and services exert a positive and statistically significant effect on economic growth, while agriculture has a statistically insignificant coefficient, and this can be explained by the fact that the oil sector leaves no room for investing in the agricultural sector. Column (c) indicates a positive and highly significant effect of oil rents on diversification index (in other words, higher oil rents leads to poor diversification, since a high diversification score indicates a low level of diversification), because oil rents encourage seeking a piece of the resource pie instead of engaging in productive activities, and they are strong enough to keep the doors locked in front of diversification strategies. As shown in column (d), concentration appears to be strongly positively influenced by oil rents that act as a powerful magnet for rent-seeking activities. Based on the results in column (e), oil rents carry the expected positive sign with high significance, whilst most of the other explanatory variables (agriculture, industry, and services) maintain statistically insignificant coefficients with unexpected signs, reflecting that the dependence on oil rents causes the concentration of economic activity in oil-rich MENA countries. Column (f) shows that there is a negative association between oil rents and governance, highlighting the fact that the overwhelming reliance on oil rents generates a poor governance framework, which in turn frustrates efforts at economic diversification. The results in the column (g) illustrates that economic freedom is significantly adversely affected by oil rents, since these oil revenues make building high-quality economic institutions more arduous. On the basis of these findings, it is concluded that MENA oil exporters have been diagnosed with resource curse. In order to examine the role of

governance in avoiding the resource curse in oil-abundant MENA countries, strengthening the foundation on which economic diversification can be built, and turning oil rents into a tool for diversifying the economy, we estimated several models (shown in Table 5) in which each governance indicator was analyzed separately for avoiding the problems of interdependence or collinearity between governance indicators.

Table 5. Regression Results for 11 Oil-Abundant MENA countries

Dependent Variable: DIV								
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
	Panel GMM- FE	Panel GMM- FE	Panel GMM- FE	Panel GMM- FE	Panel GMM- FE	Panel GMM- FE	Panel GMM- FE	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)**
R²	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.

The fixed effects GMM estimation results for each of the eight models are presented in the Table 5; governance index is negatively and significantly linked to the diversification index (see column (a)) (in other words, higher governance index leads to higher diversification, since a low diversification score indicates a high level of diversification), indicating that governance is a key ingredient in the diversification recipe. Likewise, oil rents display a

significant positive impact on diversification index in 11 oil-rich MENA countries, and this is consistent with theory, that highlights the influential role of oil rents in encouraging rent-seeking activities and frustrating economic diversification. The multiplicative interaction term between governance index and oil rents yields a significant negative coefficient, implying that the combined effect of governance and oil rents is effective in promoting diversification; further, this term is strong enough to overcome the diversification-decreasing effect of oil rents, indicating that the enhancement of MENA oil exporters' governance situation allows oil rents to serve as a crucial funding source for many other sectors and enhance economic diversification. It is also worth noting that the validity of our instruments is confirmed, because the Hansen J-statistic of over identifying restrictions is insignificant (J-statistic p-value = 0.7180 > 0.05) and therefore the null hypothesis of valid instruments cannot be rejected. As shown in column (b), governance index is broken down into six indicators in order to figure out which of those indicators matter the most for economic diversification; the diversification index appears to be strongly negatively influenced by voice and accountability, political stability, government effectiveness, regulatory quality, rule of law and control corruption, hence, these six pillars support diversification away from oil-related industries and harness oil revenues to serve diversification purposes. Column (c) reports the fixed effects GMM estimation results using the multiplicative interaction term between 'voice and accountability' and oil rents, this term yields a highly significant negative coefficient, indicating that the combined effect of 'voice and accountability' and oil rents is effective in boosting efforts to diversify oil-rich economies in the MENA region because voice and accountability prevent resource rent from being dissipated, mainly through holding those in authority strictly accountable for their actions; therefore, the diversification process can be initiated and guided by a steady pursuit of the public good, not the private interests of the rulers. As shown in column (d), the multiplicative interaction term between political stability and oil rents yields a significant negative coefficient, reflecting that the joint impact of political stability and oil rents is effective in boosting economic diversification because political stability and absence of violence induce politicians' tendency towards the efficient use of oil rents, thus laying the basis for economic diversification, they also create and maintain a favorable environment in which non-oil sectors can flourish, while political instability exacerbated by conflicts, disputes, and tensions distracts governments from vital domestic reforms and hence cripples economic diversification efforts. Based on the results in column (e), the multiplicative interaction term between government effectiveness and oil rents carries the expected negative sign and is statistically significant at the 1-percent level, implying that the combined effect of 'government effectiveness' and oil rents is of paramount importance in accelerating diversification because government effectiveness increases pressure on public service providers to deliver quality public services, enhances the capacity and skills of civil servants, and enables the government to produce and expeditiously implement good resource management policies in line with diversification requirements. Column (f) shows that there is a negative significant association between the multiplicative interaction term (RQ*OILR) and diversification index, this can be explained by the fact that the presence of regulatory quality encourages oil-rich governments to pursue market-friendly policies and remove onerous regulatory burdens holding back economic diversification and growth. Column (g) illustrates that the relationship between the multiplicative interaction term

(RL*OILR) and diversification index is negative and significant at the 1 percent level, since the rule of law curtails the ruling elite's attempt to use oil rents to further their own interests and leaves room for diversification through contributing to a more business- and citizen-friendly environment. A quick glance at the column (h) reveals that control of corruption protects oil rents from the ravenous behavior of bad politicians and improves the management of oil rents and hence it can best serve the diversification process because the multiplicative interaction term (CC*OILR) is highly statistically significant and has the expected sign. A necessary condition for promoting diversification is the pre-existence of a stable political system which is able to control corruption. It is also worth noting that the validity of our instruments in eight models is confirmed, since the Hansen J-statistic of over identifying restrictions is insignificant in each model and therefore the null hypothesis of valid instruments cannot be rejected. In a nutshell, the enhancement of MENA oil-exporters' good governance capabilities is the way out of the resource curse because it is the only mediator that can reconcile the twin goals of diversifying economic activity and yielding benefits from oil endowment, hence turning oil wealth into a boon, or more simply put, the building up of good governance can offer these oil-abundant countries more opportunities for economic diversification and give them much greater immunity to resource trap and thereby can enable them to generate robust and sustainable economic growth.

Table 6. Regression Results for CNM (Canada, Norway and Malaysia) and GCC Countries

Dependent Variable: DIV				
	(a)	(b)	(c)	(d)
	OLS FE -CNM-	OLS FE -CNM-	OLS FE -GCC-	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)***
R²	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.

This paper aims to compare the diversification experience of Canada, Norway and Malaysia to that of GCC countries. The results for each of the four models are presented in the Table 6. As shown in columns (a) and (c), governance index is negatively and significantly linked to the diversification index (in other words, higher governance index leads to higher diversification) in both CNM group (Canada, Norway and Malaysia) and GCC countries; an increase of 1% in governance leads to a decline of 0.11% in diversification in CNM group (in other words there will be an increase of 0.11% in economic diversification since a low diversification score indicates a high level of diversification), while an increase of 1% in governance leads to a decline of 0.23% in diversification in GCC countries. Therefore, the rate of improvement in diversification brought by governance is higher in GCC countries than in CNM group because more efforts are needed from GCC countries to catch up with CNM group's governance levels; closing the governance gap determines how quickly GCC countries can promote economic diversification. Based on the results in columns (a) and (c), oil rents exerts a significant negative impact on the diversification index in CNM group, implying that oil rents enhance the diversification process in a good governance framework, while oil rents display a significant positive impact on the diversification index in GCC countries, highlighting the important role oil rents play in encouraging rent-seeking activities and delaying economic diversification especially with persistent loopholes in current governance framework in GCC countries. Column (b) indicates that all six governance indicators have a negative and significant impact on the diversification index in CNM group, while column (d) reveals that voice and accountability (VA) and political stability (PSAV) have negative but statistically insignificant relationships with the diversification index in GCC countries; this is expected since there are glaring weaknesses in institutions of accountability in GCC countries, where oil revenues go directly from oil companies to the state budget without obtaining feedback from citizens. As a result, these governments are not held accountable for how and where oil rents are spent. Most GCC countries show no willingness to demonstrate accountability. Citizens of GCC countries cannot freely express their economic and political grievances. Nonexistent or poorly performing accountability mechanisms often translate into bad economic decisions, irrational policy preferences, deficiencies in policy-making, and ultimately, low levels of economic diversification combined with high levels of dependence on oil. Furthermore, there is a deep division within the Gulf Cooperation Council (GCC) as the blockade of Qatar enters its third year. This crisis certainly negatively affected the GCC at first. So far, efforts to resolve the most serious dispute to date within the GCC have failed. All these conflicts, disputes, and tensions exacerbate political instability and distract governments from vital domestic reforms and hence cripple economic diversification efforts.

7. Conclusion

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) over the period 1996-2018. This paper aims also to compare the diversification experience of Canada, Norway and Malaysia to that of GCC countries, by using pooled OLS, fixed effects, random effects and generalized method of moments (GMM) estimators. The main findings indicate that diversification, good governance and oil rents lay the foundation for sustainable growth in MENA oil exporters. Oil rents exhibit a statistically significant positive effect on economic growth. Industry and services exert a positive and statistically significant effect on economic growth, while agriculture has a statistically insignificant coefficient, and this can be explained by the fact that the oil sector leaves no room for investing in the agricultural sector. Oil rents encourage seeking a piece of the resource pie instead of engaging in productive activities, and they are strong enough to keep the doors locked in front of diversification strategies. The results also indicate that the overwhelming reliance on oil rents generates a poor governance framework, which in turn frustrates efforts at economic diversification. On the basis of these findings, it is concluded that MENA oil exporters have been diagnosed with resource curse.

Furthermore, the fixed effects GMM estimation results reveal that governance is a key ingredient in the diversification recipe, while oil rents frustrate economic diversification by encouraging rent-seeking activities. The multiplicative interaction term between governance index and oil rents indicates that the combined effect of these two variables is effective in promoting diversification, in other words, the enhancement of MENA oil-exporters' governance situation allows oil rents to serve as a crucial funding source for many other sectors and enhance economic diversification. In fact, the diversification index appears to be strongly negatively influenced by voice and accountability, political stability, government effectiveness, regulatory quality, rule of law and control of corruption, hence, these six pillars support diversification away from oil-related industries and harness oil revenues to serve diversification purposes.

Moreover, the results also show that the rate of improvement in diversification brought by governance is higher in GCC countries than in CNM group (Canada, Norway and Malaysia) because more efforts are needed from GCC countries to catch up with CNM group's governance levels; closing the governance gap determines how quickly GCC countries can promote economic diversification. Oil rents enhance the diversification process in CNM group that enjoy a good governance framework, while oil rents encourage rent-seeking activities and delay economic diversification especially with persistent loopholes in current governance framework in GCC countries. Voice and accountability and political stability have statistically insignificant relationships with the diversification index in GCC countries; this is expected since there are glaring weaknesses in institutions of accountability in GCC countries. Nonexistent or poorly performing accountability mechanisms often translate into bad economic decisions, deficiencies in policy-making, and ultimately, low levels of economic diversification combined with high levels of dependence on oil. Further, disputes, and tensions exacerbate political instability and distract governments from vital domestic reforms and hence cripple economic diversification efforts in GCC countries.

More than ever, MENA oil exporters must diversify their economies by embarking on more decisive structural reforms from the beginning and improving the management of their oil revenues and public finances.

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.

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.

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. Providing a solid framework for economic diversification requires engaging in fruitful, interactive, deeper and more clearly focused dialogues with key stakeholders, including private sector representatives, about the suitability of economic policies implemented, various costs and benefits of diversification strategies pursued, and good governance that ensures the prudent use of public resources for diversification purposes. It is in the interest of the lower and the middle classes to support the development of a more diversified economic base. Thus, social pressures have been mirrored by equally vocal calls for realistic and attainable goals and proper economic policies.

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