

Oil rents and economic growth in oil-abundant MENA countries: Governance is the trump card to escape the resource trap

Siham Matallah¹, Amal Matallah²

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 1996-2014, by using pooled OLS, fixed effects, random effects and generalized method of moments (GMM) estimators. The main findings indicate that MENA oil exporters' growth is greatly and positively influenced by oil rents. Likewise, these economies have been diagnosed with resource curse. The results also show 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 a nutshell, the enhancement of MENA oil-exporters' good governance capabilities is the way out of the resource curse because it can turn oil wealth into a boon and offer these oil-abundant countries more opportunities for economic diversification and thereby can enable them to generate robust and sustainable economic growth.

Keywords: Oil Rents; Economic Growth; Resource Curse; Governance; Oil-abundant MENA countries

JEL Classification: O17, O43, O53, Q33, Q38.

¹ University of Tlemcen, Algeria. Email: siham.maatallah@yahoo.com

² University of Tlemcen, Algeria. Email: amel.matallah@yahoo.com

1. Introduction

The governance-natural resources nexus has been intensely debated in recent decades, and many economists have highlighted the intrinsic role played by institutions and good governance practices in escaping the resource curse and reversing it (Barro 1991; Sachs-Warner, 1995; Barro and Sala-i-Martin, 1995; Sala-i-Martin, 1997; Mehlum et al., 2006; Robinson et al, 2006). According to Elbra (2013) the resource curse can be perceived as “*the paradox by which mineral-rich states fail to keep pace, economically, with their non-mineral-rich peers*”; this anathema depicts the case where an abundance of natural resources does not enable many countries to achieve high sustainable growth rates and poverty reduction goals (Costa and Santos, 2013). Also, the resource curse phenomenon is often associated with pervasive corruption, a lack of secure property rights, persistent high unemployment and glaring income inequalities (Colgan, 2014). Sachs and Warner (1999) asserted that resource-rich countries suffer from weak performing manufacturing sectors compared to resource-poor countries, because resource rents swallow economic agents’ saliva and entice them to engage in rent-seeking activities, breaking the backbone of economic growth.

Institutional frailty is a troubling truth behind the synchronization between resource abundance and the vicious circle of unsustainable growth, because it ensures that resource rents will be misguided and misused in unproductive rather than in productive directions. Moreover, Alexeev and Conrad (2011) claimed that the overdependence on natural resource rents carries harmful effects for the resource-rich country’s institutional context, and these effects can persist for a long time, thus threatening long-term economic growth; this situation is perhaps common to many resource-abundant transition countries that have experienced significant institutional changes; and to make bad matters worse, point-source natural resource endowment often hampers government’s willingness to proceed with necessary institutional reforms and hence increasing signs of growth unsustainability.

Indeed, many historical facts have explored that resource-poor countries tend to grow faster than resource-abundant countries; it's also worth bearing in mind that natural resource wealth was not the main driving force behind the countries’ economic success in the past. Despite abundant natural resources, Norway and Botswana have harnessed their natural resource windfalls to generate robust growth rates, and their experiences serve as good lessons to natural resource-endowed countries (Larsen, 2005; Holden, 2013). The Norwegian government has isolated oil rents from politically-induced goals by allocating them to productive investments under a transparent operational framework (Tsani, 2013). Similarly, Acemoglu et al. (2002) pointed out that Botswana has successfully managed its natural resource rents due to its sound governance practices and high-quality institutions especially in terms of property rights that have hitherto been mainly influenced by pre-colonial institutions. This shows the wisdom of insisting first and foremost on stepping up institutional reforms and building up good governance that is the way out of the resource curse owing to its ability to turn natural resource wealth into a boon and enable resource-abundant countries to generate robust and sustainable economic growth. But what we’ll see if we change the viewing angle and turn the spyglass towards oil-abundant MENA countries?

In fact, MENA oil exporters, heavily dependent on oil export revenues, are vulnerable to the triple whammy of falling oil prices, expenditure cutback and sluggish growth. If oil prices stay low and remain in the dumps, then these countries are expected to post stinging losses in oil royalties. This situation, combined with unchanged spending, will cause the budget surplus in some countries to dwindle, and of course other countries, especially those with insufficient buffers, will not be denied a galloping budget deficit. Actually, the need for setting up precautionary buffers to cope with oil price volatility and deal with emergencies has long been felt, but even substantial buffers can be fully exhausted if oil prices continue to slide. Unfortunately, besides the looming problem of the resource curse, the plunge in oil prices may not leave policy makers elbow room for maneuver, and this could be the straw that breaks the camel's back. The deep roots of today's emergency situation can be revealed with a glance back at these countries' governance and institutional tissue. 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 examine 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 1996-2014. Therefore, the paper is divided into five sections. After introducing the topic in section 1, section 2 presents the theoretical background and empirical indicia relating to the triptych resource curse-good governance-economic growth, section 3 discusses oil rents, economic growth and good governance in oil-abundant MENA countries, section 4 introduces the data, explains the methodology, and analyzes the empirical results and finally section 5 concludes the paper and draws some policy implications.

2. Theoretical and Empirical Review on Resource Curse and Good Governance and the Links with Economic Growth

A- The Resource Curse: Implications and a Glance at Successful Experiences

The resource curse reflects the case where natural resource wealth is associated with poor economic performance (Bjorvatn et al., 2012). In a nutshell, the following are the main symptoms of the resource curse phenomenon: (1) the exaggerated reliance on natural resources; (2) the frustrating effect of real exchange rate appreciation, resulting from natural resource exports, on other economic sectors; (3) the short-term rise in inflation; (4) the commensurate fall in consumption in response to high commodity prices; (5) the inefficient control over public spending; (6) the pervasiveness of corruption (Costa and Santos, 2013).

As a matter of fact, natural resource rents are often used to fuel government spending on infrastructure, telecommunication, health care and educational services; thus, they can promote economic growth, but the puzzling fact is that the impact of those rents remains positive, then after a certain threshold it turns negative, especially under institutional deficiencies (Papyrakis and Gerlagh, 2004; Mehrara, 2009). It is widely held among economists that resource rents can switch entrepreneurs' interest from productive endeavors to rent-seeking activities and hence economic growth will be severely hampered (Bjorvatn et al., 2012). Further, natural resource

abundance can cause structural distortions which may have a growth-reducing impact (Bjorvatn and Farzanegan, 2013). Large-scale resource extraction activities can lead to higher real wages and real exchange rate appreciation, hindering competitiveness and production in non-resource sectors (Kolstad and Wiig, 2009). Also, the resource abundance may lead to low levels of human development and high levels of poverty and inequality by inducing governments to swerve aside from welfare-enhancing policies (Al-Kasim et al., 2013). As well as, the overwhelming reliance on natural resources generates a poor institutional framework and market failure which in turn further dampen the economy's growth potential (Boyce and Emery, 2011).

Sachs and Warner (1995) indicated that natural resource-endowed countries tend to grow slower than resource-poor countries. But actually natural resource-abundant countries like Norway and Botswana are often cited as successful examples of harnessing natural resource wealth for economic growth. In fact, the Norwegian government has skillfully managed its oil revenues, owing to its belief that the oil wealth belongs to the whole country and it should be wisely used to benefit the entire population. Norway was keen to involve national oil companies in the petroleum industry, because ensuring that natural resources are extracted by national companies is the major stride towards the resource blessing (Pomfret, 2012). Further, oil rents were invested abroad through the Government Pension Fund. Importantly, the Norwegian companies have entered national and international capital markets, thus securing sufficient funding for profitable investments and it is worthwhile to note that democracy and stability have arisen in Norway before the discovery of oil; also, the institutional basis has long been supported by the well-functioning bureaucracy, low levels of corruption, and law enforcement (Holden, 2013). Likewise, Acemoglu et al. (2003) indicated that Botswana has successfully managed to escape the resource curse through enforcing property rights, providing checks and balances on the executive power, and facilitating infrastructure investment. By contrast, surrounding resource-rich nations like Angola, Sierra Leone and Congo plagued by poor institutional quality have had struggling economies. As a matter of fact, many oil-exporting developing countries fail to generate sustained economic growth, and this may be partly explained by the fact that the oil sector leaves no room for investing in the other non-oil sectors (Stevens and Dietsche, 2008).

B- The Natural Resource Trap: How Much Do Governance and Institutions Matter?

Bjorvatn et al. (2012) asserted that the massive rent-seeking behavior associated with resource endowment can cause a pallid growth, and even more it can trigger a lengthy period of political unrest. Further, Kolstad and Wiig (2009) pointed out that the resource wealth often causes a dysfunctional behavior, especially in a prosaic institutional structure. In point of fact, uncertainty, political strife and economic recession may result when greedy elites exploit natural resources ruthlessly for their own self-interests, ignoring the public interest (Jayakar and Martin, 2012). To make matters worse, resource-endowed countries may use resource rents to put out the fire of potential internal conflicts and buy peace, and it is worthwhile to note that the resource abundance helps sustain bad political regimes and undermine any transition to democracy (Stevens and Dietsche, 2008). However, resource-rich countries with good

institutions designed for conflict prevention and stability maintenance are, therefore, less vulnerable to such dire situations that not only exacerbate the resource curse but also make political and economic bombs that can explode at any moment (James and Aadland, 2011).

In the same vein, Kolstad and Søreide (2009) emphasized that corruption is the underlying force behind the poor economic performance of resource-rich countries. Additionally, the corrupt behavior stemmed from increasing resource rents encourages individuals to seek a piece of the resource pie instead of engaging in productive activities. Also, corruption persuades politicians to stay in power, causing a tremendous lack of accountability, inefficient allocation of public funds and serious distortions in the economy. More precisely, power-hungry governors in resource-rich countries take advantage as much as possible and keep themselves engaged in corrupt conduct and wasteful rent-seeking behavior, thus they deprive their economies of prosperity (Stevens and Dietsche, 2008). For instance, countries endowed with substantial natural resources may regard trade liberalization as superfluous under harsh environments plagued by institutional deficiencies and corruption (James and Aadland, 2011). Undoubtedly, corruption and political conflict resulting from resource abundance make policy makers less inclined to uphold the country's economy and induce them to deliver low quality public goods and services, and ignore citizens' needs (Neumayer, 2004; Cavalcanti et al., 2011).

Moreover, natural resource-endowed countries' ruling elites tend to build an institutional tissue that enables them to seize resource rents, they also inhibit democratic accountability and make no effort to improve institutions that regulate private sector activities, affect the relative profitability of productive activities, and curb rent-seeking activities (Ross, 2001; Kolstad and Søreide, 2009). In general, poor institutional quality induces politicians' tendency towards the inefficient use of resource rents to pursue their electoral goals (Robinson et al., 2006). In contrast, a strong institutional basis can preserve resource-rich countries from the ravenous behavior of politicians and bureaucrats (Stevens and Dietsche, 2008). In fact, the impact of natural resource booms counts on political institutions which can hold politicians accountable and enable countries to reap the benefits of their resource wealth (Robinson et al., 2006). In addition, transparency helps counteract the bane of natural resource richness (Oskenbayev et al., 2013). Similarly, Stevens and Dietsche (2008) emphasized that transparency can safeguard sound public finances, build citizens' trust in their governments, and enhance government's credibility and accountability. Thus, the lack of transparency can severely exacerbate resource curse problems and undermine economic growth. Admittedly, ample research evidence confirms that the institutional improvement helps escaping the pitfalls of the resource curse; therefore, countries suffering from this damn should increase their protection of property rights and enforce vigorous anti-corruption policies and procedures (Costa and Santos, 2013).

It can be concluded that natural resources are not the only driving force behind the resource curse but also low-quality institutions dampen economic growth and make matters worse (Boschini et al., 2013). Thus, the problem lies not in the resource abundance, but in the way of managing resource rents, and the ability of policy makers to establish the appropriate institutional structure and implement growth-promoting policies (Cavalcanti et al., 2011). Indeed, low levels of corruption, solid rule of law and robust democratic institutions can ensure prudent management of windfall gains from natural resources and improve fiscal performance

and hence foster economic growth (El Anshasy and Katsaiti, 2013). As well as, natural resource-endowed countries must change track to ride the wave of prosperity by focusing on economic diversification that can broaden their economic base and provide insulation from the resource curse (Kolstad and Wiig, 2009; Wiig and Kolstad, 2012).

C- Diversification: A Way Out of The Resource Curse, But What About The Main Binding Constraints Facing This Process?

Economic diversification is a better shield against the resource curse by widening the country's economic base in a way that progressively delinks economic growth from resource abundance. In fact, diversification highlights differences in growth patterns between resource-rich countries and those poorly endowed with natural resources (Parlee, 2015); it also means that the economic growth is drawn from more than one sector, and it can take place within a specific sector or it can simply reduce the extent of concentration across sectors (Wiig and Kolstad, 2012). Chile, Brazil, Indonesia, Malaysia, Mexico and Sweden, for example, explain how some resource-rich countries were able to find ways to reduce their resource dependency and successfully diversify their economies and why they have done better than others in terms of maintaining sound economic growth (Joya, 2015).

Economic diversification is a pillar of sustainable economic growth, it is the process by which resource-rich countries counteract instability and escape the worldwide slump in resource prices. Furthermore, diversification has the ability to solve the unemployment problem and point institutions in the right direction, and hence, it is a cornerstone of the peacebuilding process. Since it is evident that diversification entails substantial benefits in many crucial ways, the following question immediately comes to mind: why don't oil-abundant countries diversify more?, there are many reasons for this, such as the lack of clear guidelines on diversification, the entire support to heavily energy-dependent industries, the inadequate support to non-oil sectors, and the private sector's dependence on government spending (Albassam, 2015). Omgba (2014) claimed that export diversification is greatly and positively influenced by the time period elapsing between oil production starting date and independence date, for example older oil-producing countries will have had enough time to diversify their export bases, as compared to those that recently started exporting oil. Perhaps the answer is hovering around political interests; in other words, the diversification process can pose a sufficiently serious threat to the incumbent's hold on power which in turn can make any potential economic benefits too small to be seen with the naked eye, because garnering and maintaining political power already ensures retaining gains. Actually, the ruling elite's satisfaction with available sources of income is strong enough to keep the doors locked in front of diversification strategies especially those that exert a menace over the seats of power. A further implication, here, is that even if a process of diversification has been taking place, then it will be more skewed towards political payoffs at the expense of societal ones. This explains why the implementation of genuine diversification policies has failed to bear fruit in many resource-rich developing countries (Wiig and Kolstad, 2012).

Moreover, the pace of diversification is greater in resource-poor countries where colonizers created settlement colonies and brought with them good institutions, than in

resource-rich countries where settlers set up extractive colonies, in which institutions were ideally designed to effectively extract resources, it's also worth bearing in mind that these institutions persisted after independence due to the ruling elite's goals and worries (Acemoglu et al., 2001). Indeed, the better the resource-rich countries' institutional quality is, the more likely these countries' economic base will be diversified. Diversification depends greatly on resource-rich countries' institutional quality, or more simply put, good quality institutions offer resource-abundant countries more opportunities for export basket diversification, and give them much greater immunity to export concentration and resource trap. Additionally, diversification requires reducing the tax burden on non-oil sectors and waiving trade restrictions biased towards oil products (Wiig and Kolstad, 2012). Further, resource rents can serve as productive assets, contributing to economic diversification, which in turn can offer an easy way out of the resource curse dilemma by efficiently allocating resources to their most productive uses (Joya, 2015), and it is also important to emphasize here the leading role played by education in enabling and empowering people, strengthening their own capacities and making them aware that their actions are of paramount importance in supporting the country's economic diversification. In general, achieving diversification requires a burning desire instead of dreading the cost of the process. Obviously, the first step in embarking on promising diversification processes is to build a thoughtful and measurable plan with realistic, clearly defined, and action-oriented goals, and it's worth mentioning that this plan should be executable (Albassam, 2015).

D- The Triptych Good Governance-Diversification-Economic Growth: Is Natural Resource Wealth a Boon or a Bane?

The interaction between natural resource revenues and prosaic forms of governance can render resource-rich countries financially underdeveloped, and lead to imprudent fiscal and monetary policies, weakening the foundation on which economic diversification and sustainable growth build (Bhattacharyya and Hodler, 2014; Weinthal and Luong, 2006). Additionally, the shift from productive activities to rent-seeking activities lies on the activity's profitability, which in turn requires an efficient business environment supported by good governance (Omgba, 2015). According to Karshenas and Hakimian (2005) export diversification is driven by both domestic and foreign private investment that is responsive to the quality of institutions. Likewise, human capital development is a key ingredient in the diversification recipe that requires more than the existing human capital used in the easy oil-growth, this capital can grow only within a proper institutional framework that reduces the magnetic coupling between resource rents and corrupt practices, because this dangerous explosive mixture is the arch-enemy of human capital development in resource-abundant countries, thus, along with human capital development, diversification can make a giant and constructive stride forward in widening the doors of employment opportunities, thereby enhancing growth prospects (Al-Rawashdeh et al, 2013). While, poor governance contributes appreciably to the depletion and degradation of natural resources, instead of spending them to lay the basis for economic diversification and sustainable growth. In fact, the building up of powerful institutions is the only mediator that can reconcile the twin goals of diversifying economic activity and yielding benefits from natural resource endowment. Admittedly, good

governance practices cannot only pressure governments to use resource wealth wisely in paving the way for fledgling sectors, but also create and maintain a healthy business climate in which these sectors can flourish and make significant contributions to national economies (OECD/United Nations, 2011).

The successful injection of governance into the field of the resource curse has led Iimi (2007) to conclude that most governance indicators that influence economic diversification to allow for a sustainable growth path are as follows: First, voice and accountability does a lot to prevent resource-rent dissipation, especially by monitoring those in authority and holding them accountable, hence the diversification process can be initiated and guided by the pursuit of the public interest. Second, government effectiveness enhances the ability of civil servants to deliver quality public services and requires them to understand their responsibilities, develop new competences, and implement good resource management policies according to the growth and diversification requirements. Third, the absence of regulatory quality makes it easier for the government to pursue market-unfriendly policies and impose excessive and onerous regulatory burdens, thus hindering natural resource development and frustrating diversification by leaving the resource sector bleeding in public hands. Fourth, control of corruption reflects the effective implementation of anticorruption policies that are crucial for clear, transparent, non-discriminatory distribution of resource benefits, and that tend to be conducive to adopt appropriate resource management practices and hence they can best serve the diversification process and help resource-rich countries to attain sustainable economic growth. Further, the presence of extensive and vigorous anti-corruption policies curtails the ruling elite's attempt to use resources and act in their own best and narrow interests rather than in the interests of the people (Iimi, 2007). In a nutshell, these four pillars support a diversification away from over-reliance on natural resources and seem to transform resource wealth in a way that can generate stable and sustainable growth rates, or more aptly put, governance framework determines whether the resource abundance turns out to be a boon or a bane for natural resource-abundant countries.

The impact of oil rents on economic growth and the role of governance in avoiding the resource curse have received a great deal of attention from economists over the last decades, and the table below summarizes the main empirical studies that have been conducted to examine these relationships:

Table 1. Empirical Evidence on the Link between Resource Curse, Institutional Quality and Economic Growth

<i>Authors</i>	<i>Sample</i>	<i>Empirical approach</i>	<i>Results</i>
<i>Bulte et al., (2005)</i>	90 countries 1970-2001	Ordinary Least Squares (OLS) regression	The resource abundance negatively affects institutions concerned with government effectiveness and rule of law.
<i>Bhattacharyya and Hodler (2010)</i>	124 countries 1980-2004	Game-Theoretic Model	The link between resource rents and corruption counts on the quality of democratic institutions.
<i>Tsani (2013)</i>	27 natural resource-rich countries 1996-2007	OLS, Newey-West standard errors, Panel Corrected Standard Errors (PCSE)	Poor institutional quality aggravates the tendency for resource dependence.
<i>Libman (2013)</i>	72 Russian regions 2000-2006	Ordinary Least Squares (OLS) regression	Good institutional quality is the main driving force behind the positive effect of natural resources on growth rates.
<i>Oskembayev et al., (2013)</i>	Kazakhstan 2001-2009	2SLS model, GMM method	Resource abundance is often associated with corrupt practices and weak institutions.
<i>Papyrakis and Gerlagh (2004)</i>	47 countries 1975-1996	Ordinary Least Squares (OLS) regression	Corruption appears to significantly dampen economic growth.
<i>Andersen and Aslaksen (2008)</i>	90 countries 1970-1990, 1990-2000	LAD regression and reweighted least squares, OLS	-Rule of law exerts a significant positive impact on economic growth. -Resource abundance has a significant negative influence on economic growth.
<i>Brunnschweiler (2008)</i>	100 countries 1996-2000	OLS regressions, two-stage least squares (2SLS) estimations	There is a significant positive relationship between institutional quality and economic growth. More precisely, rule of law and government effectiveness substantially raise the rate of economic growth.
<i>Torvik (2009)</i>	87 countries 1972-2000	Ordinary Least Squares (OLS) regression	Institutional quality displays a positive and significant effect on economic growth.
<i>Mehrara (2009)</i>	13 oil-exporting countries 1965-2005	Ordinary Least Squares (OLS) regression	A sound institutional environment has a salient positive influence on economic growth.
<i>Alexeev and Conrad (2011)</i>	CIS countries 1996-2005	Ordinary Least Squares (OLS) regression,	Control of corruption has a positive and statistically

		two-stage least squares (2SLS) regression	significant impact on economic growth.
<i>Boschini et al., (2013)</i>	90-107 countries 1965-2005	Ordinary Least Squares (OLS) regression	Good institutional quality is a prerequisite for economic growth.
<i>Iqbal and Daly (2014)</i>	52 developing/transitional economies 1996-2010	Generalized Method of Moments (GMM)	Control of corruption exhibits a positive but statistically insignificant impact on economic growth.
<i>Atkinson and Hamilton (2003)</i>	91 countries 1980-1995	Ordinary Least Squares (OLS) regression	Resource-rich countries with good quality institutions attract more investments.
<i>Nili and Rastad (2007)</i>	12 oil economies, 78 non-oil countries 1960-2001	Generalized Method of Moments (GMM)	Weak financial institutions seem to affect economic growth negatively.
<i>Carmignani (2013)</i>	84 countries 1970-2010	Ordinary Least Squares (OLS) regression	High-quality institutions promote human development through reducing income inequality.
<i>Hooshmand et al., (2013)</i>	17 countries 2002- 2010	System-GMM (SGMM) dynamic panel	Good governance has a positive and statistically significant influence on financial development.
<i>James and Aadland (2011)</i>	3092 counties in the United States 1980-1995	Two-stage generalized least squares (GLS), OLS	Natural resource abundance tends to reduce real income per capita.
<i>Boyce and Emery (2011)</i>	50 U.S. states 1970–2001	Ordinary Least Squares (OLS) regression	Resource abundance displays a negative impact on economic growth.
<i>Bjorvatn and Farzanegan (2013)</i>	120 countries 1982-2006	Generalized Method of Moments (GMM), OLS regression	Resource rents crowd out the manufacturing sector and lead to lower real GDP per capita.
<i>El Anshasy and Katsaiti (2013)</i>	32 resource-abundant countries and 47 non-resource countries 1984-2008	OLS regression, 2SLS model	Good governance, stronger democratic institutions, and low levels of corruption significantly enhance economic growth.

Source: Constructed By Authors

3. Oil Rents, Economic Growth and Good Governance in Oil-Abundant MENA Countries

3.1. Oil Rents and Challenges Confronting Oil-Abundant MENA Countries

Figure 1. The Real Price of Crude Oil (\$/barrel), 1996-2016.



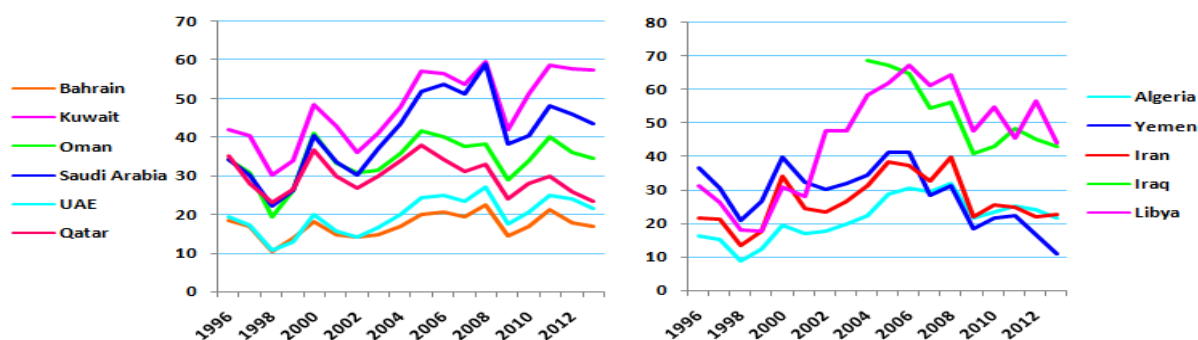
Source: U.S. Energy Information Administration (EIA), International Energy Statistics database, the data are available online at <http://www.eia.gov> (accessed 22/01/2016).

After reaching a peak of \$147 per barrel in July 2008, oil prices sagged below \$40 a barrel at the beginning of 2009, thus restraining oil production and making GCC countries swallow the bitterness of the crisis (IMF, 2009). Following the recovery in oil prices, MENA oil exporters' export earnings, fiscal and external balances began to improve during 2010-2011. However, oil GDP growth rates have remained below pre-crisis peaks, crude oil production also remained at significantly lower levels than before the crisis (IMF, 2010). Despite MENA oil exporters' steadfastness in the face of the devastating impact of the global financial crisis, these governments are still floundering in the waves stemming from oil dependency. In fact, the significant shrinking of GCC countries' considerable fiscal space has generated concerns about these countries' ability to carry out counter-cyclical policy to contain the mounting risk of falling oil prices (IMF, 2013).

Oil prices dropped sharply by \$60 to less than \$50 a barrel in January 2015 compared to July 2014. MENA oil exporters' landscape punctuated by drastic declines in oil export revenues that reached \$360 billion in 2015, has underlined the collapse in these countries' external surpluses. In fact, the GCC's current-account surplus swung to a deficit of 0.25 percent of GDP in 2015, while non-GCC oil exporters posted a current account deficit of 8¾ percent of GDP in 2015 (IMF, 2015). If oil prices stay low and remain in the dumps, then GCC countries are expected to post stinging losses in oil royalties. This situation, combined with unchanged spending, will cause the budget surplus in Kuwait and Qatar to dwindle, and will promptly turn the fiscal surplus in Saudi Arabia, UAE and Oman into a very large deficit, and of course Bahrain will not be denied a galloping budget deficit (Mottaghi, 2015).

The plunge in oil prices has been driven not just by supply-side forces but also by the expansion of shale oil production, OPEC's decision to defend its share of the global oil market, and the expected relief of nuclear-related sanctions on Iran that could revive Iranian oil exports. Given persistently lackluster global growth, China's slowing growth trajectory and the resulting decline in global demand for oil, it is not surprising that oil prices have been driven sharply lower (Husain et al., 2015).

Figure 2. Oil Rents (% of GDP) in Oil-Abundant MENA Countries, 1996-2014.



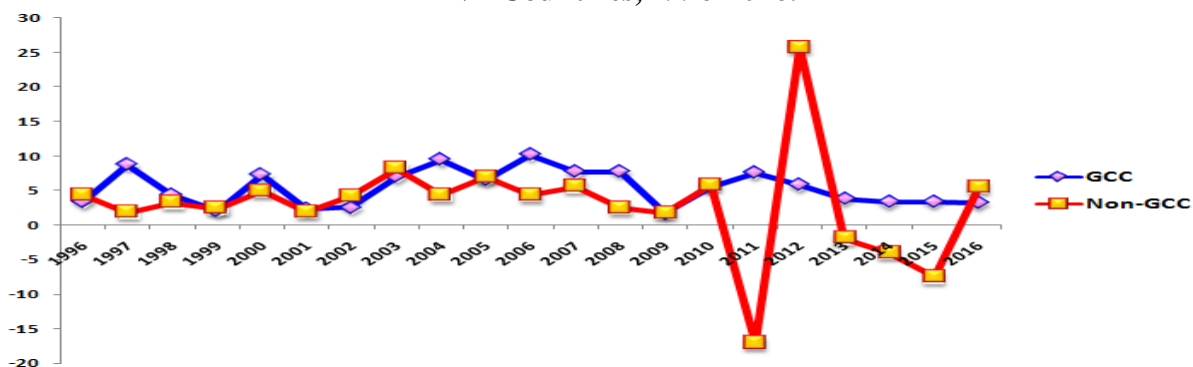
Source: World Bank, World Development Indicators, the data are available online at: <http://data.worldbank.org> (accessed 22/01/2016).

MENA oil exporters, heavily dependent on oil export revenues, are vulnerable to the triple whammy of falling oil prices, expenditure cutback and sluggish growth. Indeed, falling oil prices urge these governments to acclimate to the new situation by abruptly adjusting their expenditure and revenue policies in order to achieve fiscal sustainability, safeguard intergenerational equity, and leave policy makers more elbow room for maneuver. It's worth mentioning that MENA oil-rich countries are not yet saving enough oil wealth for succeeding generations (IMF, 2015).

Actually, the need for setting up precautionary buffers to cope with oil price volatility and deal with emergencies has long been felt. Large buffers can allow for more reasonable and gradual spending adjustment and mitigate the downward pressure that low oil prices exert on economic growth, but even substantial buffers can be fully exhausted if oil prices continue to slide. In contrast, countries with insufficient buffers need to urgently adjust their spending, taking due account of their cyclical situation. It's also worth bearing in mind that the composition of fiscal adjustment that matters most in avoiding future bottlenecks reveals a strong tilt toward retrenching, to some extent, current spending, while maintaining high-return public capital expenditures and priority social spending (IMF, 2015).

3.2. Economic Growth in Oil-Abundant MENA Countries

Figure 3. Gross Domestic Product, Constant Prices (percent change) in Oil-Abundant MENA Countries, 1996-2016.



Source: IMF, World Economic Outlook (WEO) database, the data are available online at: <http://www.imf.org/> (accessed 22/01/2016).

MENA oil exporters' growth is expected to drop by 0.25-0.5 percentage point in 2016 and fall sharply by 0.5-0.75 percentage point for the 2017–2018 period (IMF, 2015). Indeed, GCC countries' growth averaged 4.5 percent in 2014-2015 (IMF, 2014). GCC's non-oil growth is expected to slow slightly to just below 4 percent for both 2015 and 2016 after reaching an estimated 5.75 percent in 2014, especially in Saudi Arabia and the UAE. Further, ongoing fiscal consolidation efforts are projected to exert some downward pressure on GCC countries' GDP growth in the short term (IMF, 2015). While, growth in non-GCC oil exporters is projected to stay approximately flat in 2015 after growing by nearly 1.75 percent in 2014, noting that non-oil sectors in Iraq and Libya are still extremely vulnerable to ongoing internal strife (IMF, 2015). Regarding the lifting of sanctions against Iran and assumed improvements in the region's security situation, non-GCC growth is projected to pick up to 5 percent in 2016 and beyond (IMF, 2015).

It is recognized that these growth projections are however subject to many large uncertainties, notably those related to the future trajectory of global petroleum prices and emerging-market economies' growth prospects, since the recent plunge in oil prices and the envisaged fiscal adjustment can create a bleak and pessimistic view of MENA oil exporters' growth paths (IMF, 2015). In fact, the situation in Algeria and Iraq threatens to deteriorate further, because these countries have failed to contain macro-financial risks posed by heavy reliance on oil-related bank deposits, and credit exposure to state-owned companies whose existence hinges mainly on oil rents. Simultaneously, the banking sector's situation is no better in Yemen, due to its exposure to sovereign risk and the curse that has befallen the country's fiscal indicators (IMF, 2015).

It should be stressed at the outset, however, that massive GCC's infrastructure development continues at a robust pace, and provides a strong impetus towards a large-scale expansion of tourism, construction, and transport, for which these countries' reputation on the world stage keeps growing (IMF, 2014). As a matter of fact, the clear differences in economic growth between the GCC countries and non-GCC MENA countries have been heightened by the political turmoil that has spread across several non-GCC countries (IMF, 2014). Actually, protracted conflicts in Iraq, Libya, and Yemen, have not only drastically reduced growth rates in these countries but also exacerbated the spread of prolonged symptoms to neighboring countries. These struggles smashed the region-wide confidence-building process, threatening growth prospects (IMF, 2015). Additionally, there are several potential channels through which conflicts can influence economic activity. First, conflicts cause large-scale displacements, losses in both physical and human capital, a destruction of established trade routes, and massive damages to infrastructure and industrial facilities. Second, they engender and fan the flames of uncertainty, and thereby undermining conflict-ridden countries' potential growth (IMF, 2015).

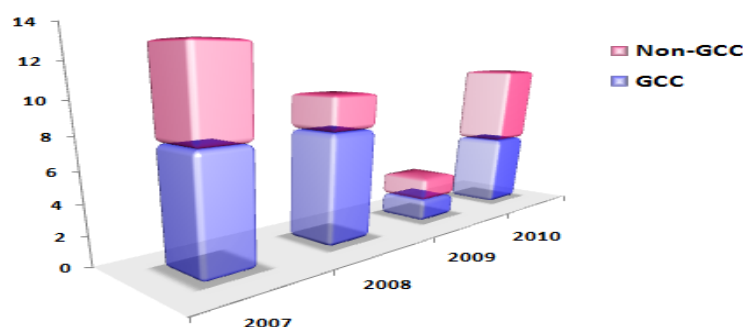
But the bitter truth is that these conflicts hit the poor hardest, since they lead to an increase in military expenditures at expense of much-needed social spending (IMF, 2015).

On the other side, exhausted fiscal buffers will leave MENA oil exporters with no choice but to expose the card of public spending cuts in order to fend off the looming crisis, but this step entails not only decreased investment spending, but also adverse implications for future

growth, especially in countries with paralyzed infrastructure, so a skewed spending towards high-return investments is a key priority (IMF, 2015). Moreover, growth slowdown forced China to back off its insatiable demand for oil, thus bringing crushing disappointments to MENA oil exporters' GDP growth (IMF, 2015).

A Glance Back at the Global Financial Crisis of 2008-2009

Figure 4. Gross Domestic Product, Constant Prices (percent change) in Oil-Abundant MENA Countries, 2007-2010.



Source: IMF, World Economic Outlook (WEO) database, the data are available online at: <http://www.imf.org/> (accessed 22/01/2016).

The global financial meltdown has hit all MENA oil exporters (through the sharp decline in oil prices, sharp drop in global demand, and abrupt reversals in capital flows), but to varying degrees, it has been especially severe in the GCC countries. Oil sector activity has contracted sharply in 2009; this alarming decline has led most governments to pursue vigorous counter-cyclical macroeconomic policies which have alleviated the hardship the crisis has brought upon the non-oil sector. The crisis has also revealed unsurprising pockets of weakness in the banking system, and has urged these governments to undertake unusual measures to cushion the impact of the crisis that has been more severe than anticipated (IMF, 2009). However, crude oil production has grown in 2010 and 2011 as oil prices have recovered, and world activity has also expanded after the global recession of 2008-2009. Hence, oil GDP has picked up between 3.5 percent and 4.25 percent in 2010-2011, but it is still lower than pre-crisis levels. However, MENA oil exporters' economic activity has recovered in 2010, albeit at a moderate pace (IMF, 2010).

The Alarm Bells Are Ringing: The Dire Need for Economic Diversification Away from Oil.

A high level of uncertainty surrounds the long-term prospects for oil futures prices that seem to be continuing on the downward path, and there is no sign of improvement in the foreseeable future, also the long term outlook remains bearish due to several reasons including the following: the darkening global economic picture, the Eurozone slowdown, the deeper-than-expected slowdown in China, China's first step towards less oil-intensive phase of development, and the recent lifting of oil sanctions against Iran (Mottaghi, 2015).

It's the closing curtain for oil boom; it's the moment of diversification away from oil; it's time for private sector job creation which is a target that MENA oil exporters really want to

make happen, but it seems impossible, given the current security and fiscal situation in the region. Notwithstanding some progress has been achieved towards economic diversification, blind reliance on oil remains the economic mainstay of MENA oil-exporting economies. Indeed, this is exactly what we should expect, if the private sector itself is heavily dependent on public expenditure (IMF, 2015). A conventional wisdom says that emphasis on collecting non-oil revenues can enhance the flexibility of an economy and increase its ability to respond to adverse shocks (IMF, 2014).

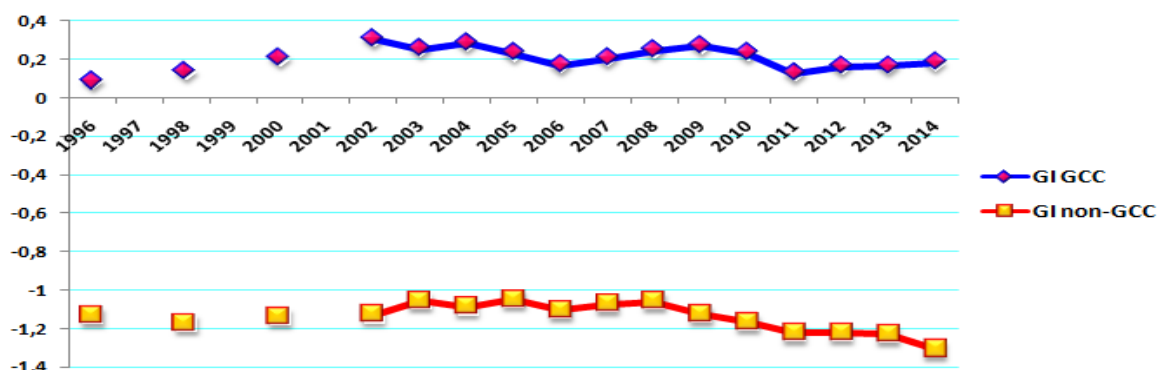
Non-oil GDP growth seems, at first sight, much more closely tied to the oil price growth, as the hike in oil prices boosts non-oil GDP growth by rising government spending. In most MENA oil-exporting countries, non-oil GDP growth rates are now even more concentrated in service industries that depend to a large extent on demand expansion resulted from oil sales, and what makes matters worse is that non-oil sectors are poorly equipped to deal with plummeting oil prices, so pursuing unsustainable fiscal policies may solidify non-oil GDP growth in the medium-term (IMF, 2014). In fact, policies targeted at creating incentives, enhancing skills in line with private sector's needs, and improving business climate may seem far-fetched, but successful experiences of diversification show that they aren't.

In light of daunting challenges that lie ahead, IMF (2014) has announced several measures that can be adopted to increase diversification, which in turn can better shield MENA oil exporters against disruptive oil price shock, these measures include:

- Enhancing the quality and effectiveness of education and reducing the skills mismatch.
- Restraining discretionary spending by cutting down the public sector wage bill and strengthening the private sector's employment- absorptive capacity.
- Phasing out energy subsidies that create an investment bias at the expense of labor and less energy-intensive sectors.
- Stepping up strenuous efforts to implement trade facilitation, broaden the region's export base, and develop a highly competitive and dynamic business environment.
- Beefing up security especially in conflict-ridden countries and recovering political stability that helps woo FDI into non-resource tradable sectors.
- Facilitating access to finance and lessening the bureaucratic burden that weighs heavily on private entrepreneurship.
- Enhancing transparency and intensifying anti-corruption efforts.
- Embarking on higher public infrastructure investment during oil boom periods.

3.3. Good Governance in Oil-Abundant MENA Countries

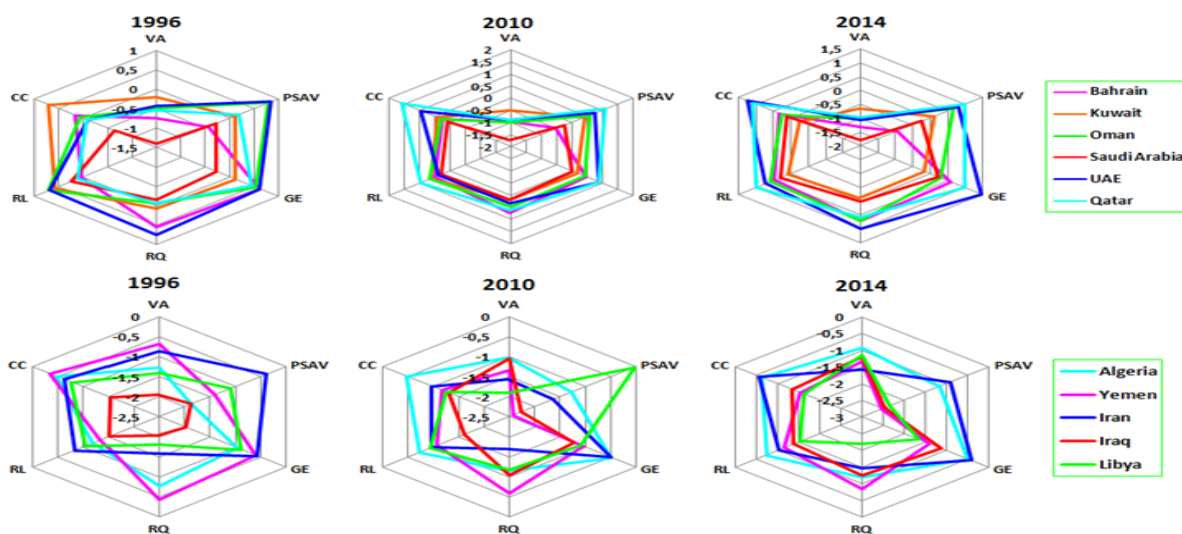
Figure 5. Governance Index (The Simple Average of Six Worldwide Governance Indicators) in Oil-Abundant MENA Countries, 1996-2014.



Source: World Bank Governance Indicators, the data are available online at: <http://info.worldbank.org/governance/wgi/index.asp> (accessed 22/01/2016).

In fact, there is a great deal of variability in governance quality across MENA oil-exporting countries. GCC countries continue to dominate the top tier of good governance scores, while non-GCC MENA countries lag behind comparator GCC countries in most, if not all, governance indicators.

Figure 6. Governance Indicators in Oil-Abundant MENA Countries, 1996, 2010, 2014.



Source: World Bank Governance Indicators, the data are available online at: <http://info.worldbank.org/governance/wgi/index.asp> (accessed 22/01/2016).

For instance, Iraq, Libya, and Yemen score lowest on political stability, government effectiveness, rule of law, and control of corruption; these factors are most responsible for hamstrung private sector in these countries whose poor ranking is a crucial indication of where oil wealth can warp institutions and hinder economic diversification. Without the existence of sound governance that creates an appropriate and enabling environment, the private sector-led growth can't be sustained or even achieved, like a fish can't live out of the water. This governance vacuum makes non-GCC MENA countries more vulnerable to heavy losses in

terms of per capita GDP growth (Akhtar, 2009), thus putting daunting challenges for most non-GCC MENA countries, notably those whose economies depend on external assistance or foreign aid.

Poor governance fascinates economic agents and gets them interested in rent-seeking activities rather than genuinely productive ones, and this situation has been exacerbated by corruption-prone institutions that are spiraling out of control. It's worthwhile to mention that, all non-GCC MENA countries scored low in the Corruption Perception Index of TI, while UAE has been adjudged to be the least corrupt country in the region. Additionally, half-way reforms have so far failed to forestall the ravages of corruption, triggering instability and making public resources a prey by opening the floodgates to powerful political predators, and it will not be surprising at all if the next generation becomes a victim.

Yemen and Iraq, plagued by political instability and terrorist attacks, have been listed as the 7th, and 12th most fragile states, respectively, according to the Fragile States Index for 2015, and they are the MENA region's most utterly failed states (Fund for Peace, 2015). In light of the Arab awakening, it becomes clear that being aware of tyrannical and oppressive actions, and demanding more transparency and accountability are the evidence that the current economic and political situation descends from the delusive peace, wonky institutional framework and misguided governance policies. The Arab spring has unveiled deep-rooted governance problems, but there has been very little improvement in the area of good governance since then.

Perhaps it is not surprising that sustaining the status quo is not just a sign of the ceaseless triumph of private over public interests, but it may seem rather a stratagem for plundering the wealth without much fuss. In fact, public service delivery took a drastic turn for the worse due in large part to deeply entrenched governance failures that exerted a colossal drag on public investment management (Heidenhof, 2014).

If we take a closer look, it seems that weak governance and poor public service delivery go hand-in-hand. It is of paramount importance to emphasize here the significance of higher education to a country's future prospects for good governance. Universities are not only places where tomorrow's leaders are born, but they are also places for preparing forceful, effective and meaningful civil society participation in the governance process, through injecting the ideas of good governance into the minds of today's youth (Mbi and Jaramillo, 2010). In this way, higher education feeds the roots of tomorrow's institutions, providing a fertile breeding ground for governance prospects. In other words, today's higher education landscape can sculpt the major features of tomorrow's good governance.

The World Bank is taking the lead on laying the groundwork upon which MENA countries can build more transparent and credible state institutions, strengthen government accountability, support open government policies, and enhance the rule of law. Because the World Bank's support can help these countries overcome several drawbacks that hinder good governance and frustrate diversification efforts, such as large and inefficient public sector, excessive state centralization, rampant public spending mismanagement, poor access to information, barriers to authentic civic participation, lack of transparency, turning blind eyes

on corrupt practices, incongruence between legislation and its implementation (Heidenhof, 2014).

It certainly is clear that deeply entrenched governance issues cannot be solved overnight; visible and tangible improvements in governance are going to take time, they may sound simple, but they require long-term commitment and great efforts on everyone's part, this laborious process can bring fruitful results to each country engaged in such endeavor only if it is not carried out on a one-size-fits-all basis. As long as these governments sought to borrow ideas and successful models that don't fit their own institutional contexts, interests and needs, the achievement of good governance can happen only in dreams and can't end up coming true.

4. 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) over the period 1996-2014, 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 2. Summary Statistics

	GDP	OILR	DIV	CONC	GI	EF	AGR	IND	SER
Mean	1.126731	32.26556	0.773177	0.652585	-0.407937	57.45260	5.268113	55.77250	39.07967
Median	0.905695	30.29599	0.786100	0.639514	-0.339609	62.50000	3.220827	55.02005	39.21169
Maximum	104.6576	68.85125	0.891602	0.982848	0.790014	77.70000	19.56317	78.51812	56.37231
Minimum	-62.21435	8.929883	0.525047	0.330178	-1.928332	15.60000	0.092542	32.04711	19.49587
Std. Dev.	11.07570	13.70917	0.070384	0.164741	0.743018	14.65946	4.595809	11.16162	8.324091
Skewness	3.442475	0.663220	-1.432449	0.128095	-0.180931	-0.983165	0.765405	0.111313	-0.194016
Kurtosis	47.27199	2.737230	5.183527	2.255581	1.697959	3.289469	2.756821	2.056992	2.402306
Jarque-Bera	16644.79	14.47555	112.9944	5.397357	13.39253	31.60195	12.11268	4.733246	2.581357
Probability	0.000000	0.000719	0.000000	0.067294	0.001236	0.000000	0.002343	0.093797	0.275084
Sum	224.2194	6130.457	161.5940	136.3902	-71.79685	11030.90	637.4417	6748.473	4767.720
Sum Sq. Dev.	24288.88	35520.89	1.030427	5.645047	96.61327	41045.88	2534.575	14949.82	8384.149
Observations	199	190	209	209	176	192	121	121	122

Source: Author's Computation Using Eviews 8.0.

The Table 2 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 1996-2014. As can be readily seen from this data, GDP has an average of 1.126 and a maximum value of 104.657, reflecting that there are certainly large regional differences in growth rates. Also, the average of oil rents is 32.26 and its maximum value is 68.851, indicating that most MENA oil exporters are heavily dependent on oil export revenues. Whilst, the average diversification index of 0.7731 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 -0.4079, reflecting that the region as a whole performs poorly in terms of governance.

Table 3. **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	-14.06594 (0.0177)**	-7.698609 (0.2984)	-14.06594 (0.2055)
DIV	-13.85522 (0.0843)*	-14.69215 (0.0368)**	-13.85522 (0.3689)
GI	1.477183 (0.0630)*	1.935721 (0.0387)**	1.477183 (0.3186)
OILR	0.129634 (0.0002)***	0.164909 (0.0012)***	0.129634 (0.0694)*
<i>R-squared</i>	0.066889	0.177696	0.066889
<i>Prob (F-statistic)</i>	0.014841	0.042313	0.014841

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

Source: Author's Computation Using Eviews 8.0.

The Table 3 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 the random effects model, 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 4. **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	8.289427	3	0.0404

Source: Author's Computation Using Eviews 8.0.

The Hausman chi-square test statistic is statistically significant at the 5% level of significance (Prob (0.0404 < 0.05)) (see Table 4), 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 strengthen the foundation on which MENA oil exporters' sustainable growth can be built. In order to examine the main symptoms of the resource curse phenomenon in oil-abundant MENA countries, we estimated several models shown in Table 5.

Table 5. **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	-4.842548 (0.0300)**	11.35533 (0.7197)	0.682901 (0.0000)***	0.545733 (0.0000)***	0.686229 (0.1409)	0.049131 (0.7296)	65.55828 (0.0000)***
AGR		0.088405 (0.8526)			0.004709 (0.4411)		
IND		-0.213121 (0.5168)			-0.006750 (0.1631)		
SER		-0.119227 (0.7027)			-0.000977 (0.8239)		
OILR	0.187373 (0.0038)***	0.181854 (0.0338)**	0.002828 (0.0000)***	0.003028 (0.0000)***	0.010995 (0.0000)***	-0.012174 (0.0021)***	-0.216249 (0.0031)***
R²	0.159792	0.249502	0.355185	0.883951	0.835159	0.058355	0.049321
Prob (F-statistic)	0.041906	0.002452	0.000000	0.000000	0.000000	0.002088	0.003053

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 5; 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 5% level of significance, while most of the other explanatory variables (agriculture, industry, and services) have statistically insignificant coefficients with unexpected signs, and this can be explained by the fact that the oil sector leaves no room for investing in the other non-oil sectors. 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 6) in which each governance indicator was analyzed separately for avoiding the problems of interdependence or collinearity between governance indicators.

Table 6. 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		0.934529 (0.0000)***	0.887710 (0.0000)***	1.412674 (0.0000)***	0.897654 (0.0000)***	0.666814 (0.0000)***	0.653085 (0.0000)***	0.930096 (0.0000)***	0.662269 (0.0000)***
GI		-0.231074 (0.0018)***							
GI*OILR		-0.003180 (0.0453)**							
VA			-0.094894 (0.0000)***	-0.508267 (0.0044)***					
VA*OILR				-0.010100 (0.0096)***					
PSAV			-0.029164 (0.0014)***		-0.097948 (0.0027)***				
PSAV*OILR					-0.001321 (0.0308)**				
GE			-0.010358 (0.6679)			-0.119979 (0.0000)***			
GE*OILR						-0.002149 (0.0000)***			
RQ			-0.047024 (0.0437)**				-0.073518 (0.0005)***		
RQ*OILR							-0.001346 (0.0157)**		
RL			-0.032063 (0.4221)					-0.306436 (0.0632)*	
RL*OILR								-0.005159 (0.0680)*	
CC			-0.027409 (0.0547)*						-0.115277 (0.0000)***
CC*OILR									-0.002242 (0.0001)***
OILR		0.003915 (0.0536)*		0.014071 (0.0148)**	0.003335 (0.0155)**	0.002640 (0.0000)***	0.002922 (0.0000)***	0.004533 (0.0676)*	0.002837 (0.0000)***
R ²		0.790273	0.892019	0.670766	0.818219	0.570230	0.450662	0.605354	0.546154
J-statistic [p-value]		0.108916 [0.741382]	0.129415 [0.719039]	0.572686 [0.449194]	0.233979 [0.628589]	0.875517 [0.349433]	0.854048 [0.355410]	0.001331 [0.970898]	0.901962 [0.342256]
N instruments		4	7	4	4	4	4	4	4
N countries		11	11	11	11	11	11	11	11
N observation		119	132	119	119	119	119	119	119

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 6; 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 = 0.07413 >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, regulatory quality, and control corruption, hence, these four pillars support a diversification away from over-reliance on oil in MENA oil exporters. 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 can ensure the pursuit of the public interest and prevent resource-rent dissipation by monitoring those in authority and holding them accountable and thus economic diversification can be initiated and guided. 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. 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 5-percent level, implying that the combined effect of 'government effectiveness' and oil rents is of paramount importance in accelerating diversification, because government effectiveness enables MENA oil-exporters to wisely use oil rents in a way that can substantially contribute to the economic diversification by enhancing the ability of civil servants to deliver quality public services and requiring them to implement good oil management policies according to 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 makes it easier for oil-rich MENA governments to pursue market-friendly policies and avoid excessive regulatory burdens, thereby further heightening diversification and leaving oil sector in private hands. Column (g) illustrates that the relationship between the multiplicative interaction term (RL*OILR) and diversification index is negative and significant at the 10 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. 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.

V. 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 1996-2014, by using pooled OLS, fixed effects, random effects and generalized method of moments (GMM) estimators. The main findings indicate that the triptych oil rents-governance- diversification has a crucial role to play in maintaining sound economic growth. Oil rents exhibit a statistically significant positive effect on economic growth, while most of the other explanatory variables (agriculture, industry, and services) have statistically insignificant coefficients with unexpected signs, and this can be explained by the fact that the oil sector leaves no room for investing in the other non-oil sectors. Further, the dependence on oil rents keeps the doors locked in front of diversification strategies and causes the concentration of economic activity. The results also show that the overwhelming reliance on oil rents generates a poor governance framework and makes 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. Thus, it can be said that the composition of fiscal adjustment that matters most in avoiding future bottlenecks reveals a strong tilt toward retrenching, to some extent, current spending, while maintaining high-return public capital expenditures and priority social spending. Indeed, stepping up strenuous efforts to implement trade facilitation, broaden the region's export base, and develop a highly competitive and dynamic business environment, and strengthening the private sector's employment- absorptive capacity, will provide oil-rich MENA countries with greater insulation from the resource curse.

Further, 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. Moreover, economic diversification appears to be strongly positively influenced by voice and accountability, political stability, regulatory quality,

and control corruption, and hence these four pillars support a diversification away from over-reliance on oil in MENA oil-exporters. To sum up, 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.

Oil-abundant MENA countries must change track to ride the wave of prosperity and attain robust and sustainable growth rates by focusing on economic diversification and enhancing good governance. In pursuit of these goals, policy makers should take into account that the first step in embarking on promising diversification processes is to build a thoughtful and measurable plan with realistic, clearly defined, and action-oriented goals, and it's worth mentioning that this plan should be executable. It's also worth bearing in mind that deeply entrenched governance issues in most MENA oil exporters cannot be solved overnight; visible and tangible improvements in governance are going to take time, they may sound simple, but they require long-term commitment and great efforts on everyone's part, this laborious process can bring fruitful results to each country engaged in such endeavor only if it is not carried out on a one-size-fits-all basis, and last but not least, it is extremely important to realize that insisting on change for the better and stepping up strenuous efforts to enhance the quality and effectiveness of education can ensure that future generations will be sufficiently vigilant in safeguarding their rights and shielding their economies against potentially damaging shocks.

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