

The Political and Economic Development of the Middle East and North Africa (MENA) Countries

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Outline

1. Policy and Politics
2. The MENA Region
3. Performance: Ultimate Goals: GDP; GDP per capita; Human Development; Inequality
4. Intermediate Variables: Resources (e.g., Oil); FDI; Exports; Tourism
5. Entrepreneurship and Finance: the Process of Development
6. Institutional Environment: Definitions; Institutions and Economic Growth
7. Strategies and Policies

1. Policy and Politics

Policy and Politics

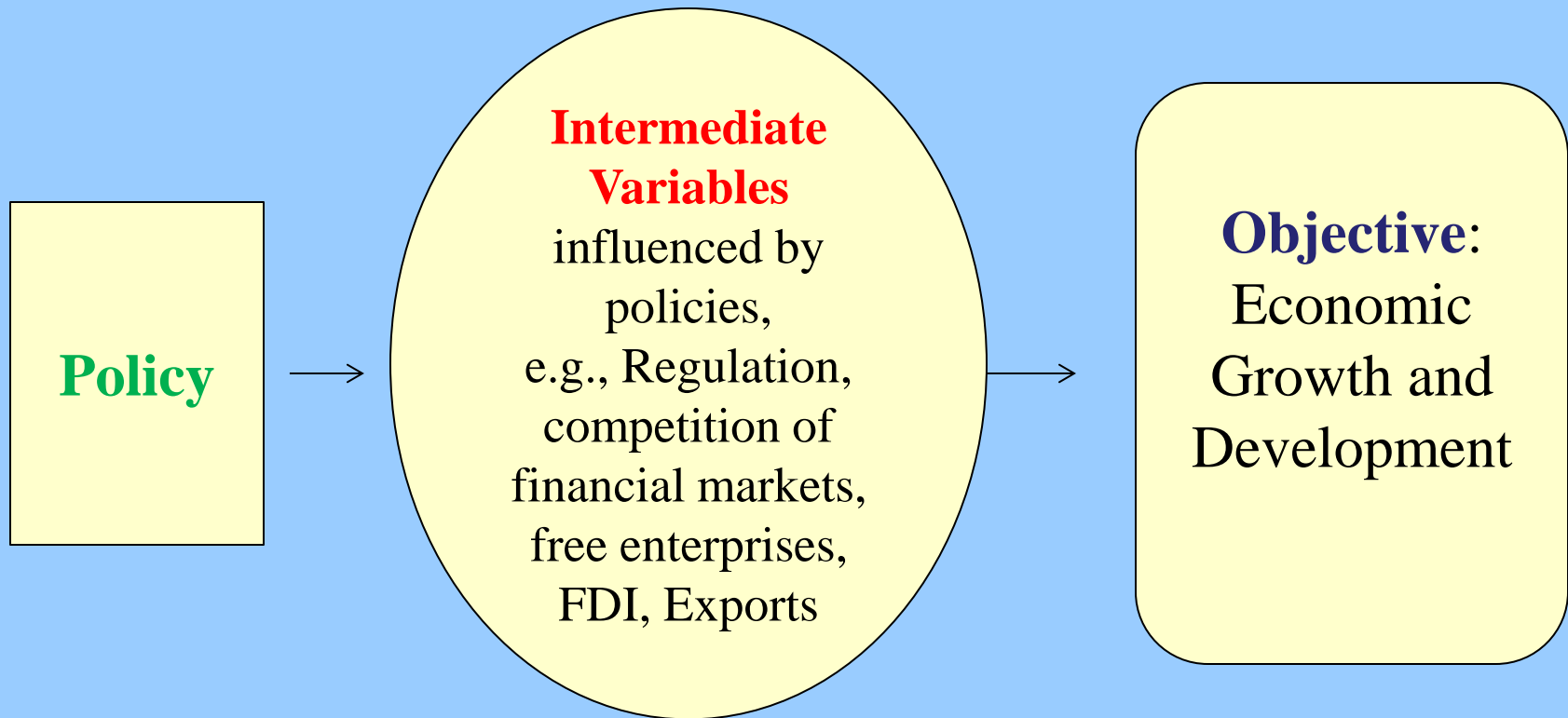
Policy and any public sector intervention and activity:

A definite course of action selected (by government, institution) - based on evidence - from among alternatives and given conditions to meet an objective and to determine present and future decisions.

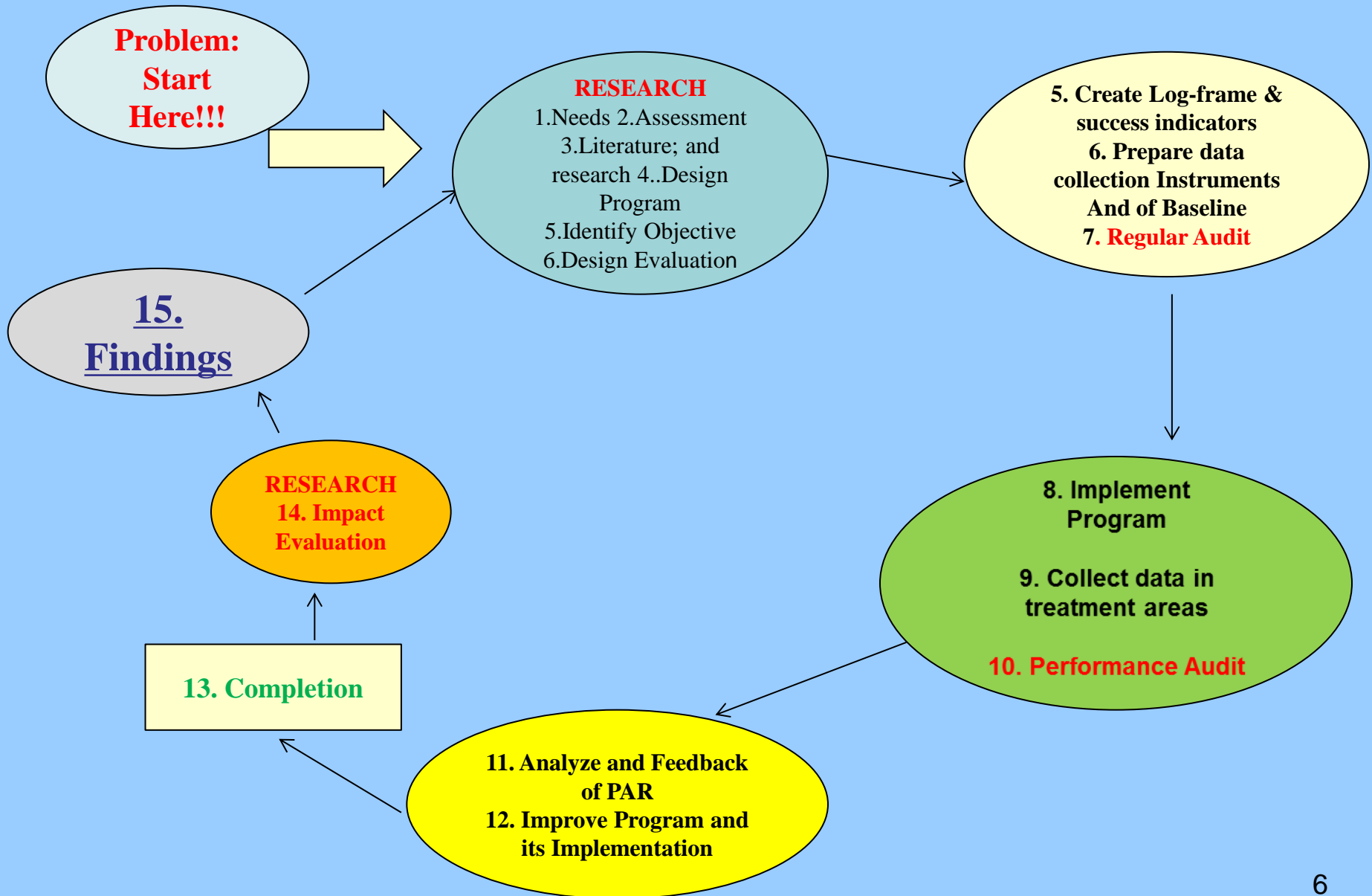
Political economy and Politics:

The art or science concerned with guiding or influencing governmental policy and winning and holding control over a government to promote given interests.

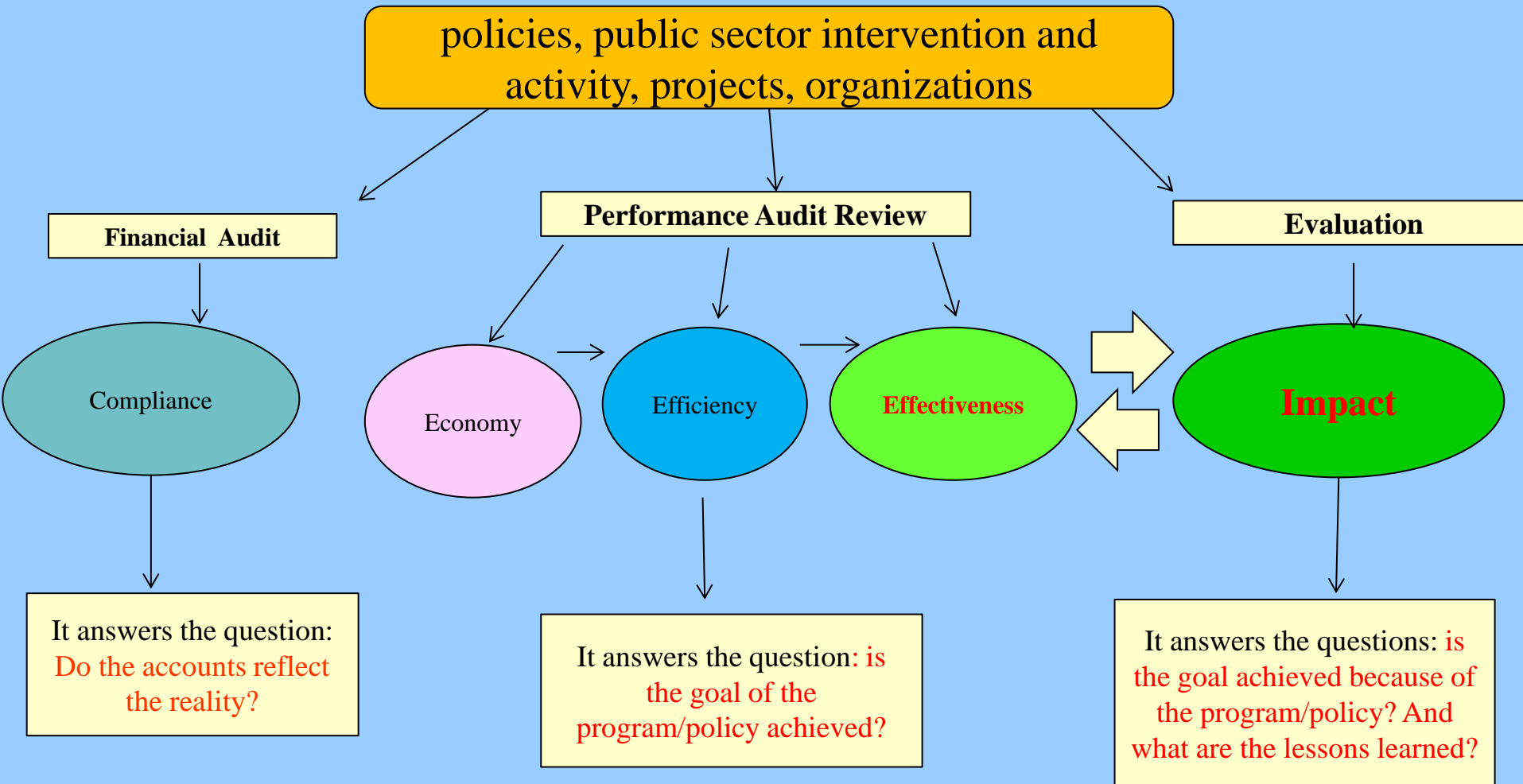
Policy, Variables, Objectives



The Sequence of Policy Intervention



Traditional Audit, Performance Audit and Evaluation



Why Evaluation?

First, it is the cost opportunity!!!!

Public policies and interventions receive taxpayers' money in various forms, direct and indirect. Therefore it is reasonable to ask whether these public sector funds are used effectively and efficiently and if the desired impact is reached relative to the next best alternative use of these public funds.

Second, it is learning and evidence based policy:

Impact evaluations provide important information to experts, practitioners and policymakers about the types of products and services that work best for particular types of clients.

2. The MENA Region

The MENA Region

The term covers an extensive region and several countries extending from Morocco to Iran, including the majority of both the Middle Eastern and Maghreb countries. The term is roughly synonymous with the term the Greater Middle East (which is also sometimes taken to include Afghanistan).

The population of the MENA region at its least extent is about 381 million people, about 6% of the total world population. At its greatest extent, its population is roughly 523 million.

The MENA Region



Classification of MENA Countries

The diversity of the MENA region could be segmented in many different ways. Two of the most notable defining characteristics among MENA countries are the availability of oil resources and the size of their native populations. MENA countries can be classified in three main groups according to Population and Hydrocarbon Resources:

Resource-rich, labor-abundant countries are producers and exporters of oil and gas and have large native populations, which represent almost the totality of their residents. This group of countries includes **Algeria, Iraq, Syria, and Yemen.**

Resource-rich, labor-importing countries are producers and exporters of oil and gas and have large shares of foreign or expatriate residents, who represent a significant percentage of the total population, even the majority in some cases. This group of countries comprises the Gulf Cooperation Council (GCC) members (**Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates**) and **Libya.**

Resource-poor countries are small producers or importers of oil and gas. These countries include **Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Tunisia, and the Palestinian Authority.**

Source: Adapted from World Bank (2007)

Classification of MENA Countries

Classification MENA Countries							
MENA	MENA Low Income	MENA Middle Income	MENA High Income	Gulf Co-operation Council (GCC)	Non Co-operation Council (Non-GCC)	Mediterranean	non-Mediterranean
Albania						Albania	
Algeria		<i>Algeria</i>			<i>Algeria</i>	Algeria	
Bahrain			<i>Bahrain</i>	<i>Bahrain</i>			Bahrain
Cyprus						Cyprus	
Djibouti	<i>Djibouti</i>						Djibouti
Egypt		<i>Egypt</i>			<i>Egypt</i>	Egypt	
Greece						Greece	
Iran		<i>Iran</i>			<i>Iran</i>		Iran
Iraq		<i>Iraq</i>					Iraq
Jordan		<i>Jordan</i>			<i>Jordan</i>	Jordan	
Kuwait			<i>Kuwait</i>	<i>Kuwait</i>			Kuwait
Israel			<i>Israel</i>		<i>Israel</i>	Israel	
Lebanon		<i>Lebanon</i>				Lebanon	
Libya			<i>Lybia</i>			Libya	
Malta						Malta	
Morocco		<i>Morocco</i>			<i>Morocco</i>	Morocco	
Oman		<i>Palestine</i>	<i>Oman</i>	<i>Oman</i>			Oman
Palestine						Palestine	
Qatar			<i>Qatar</i>	<i>Qatar</i>			Qatar
Saudi Arabia			<i>Saudi Arabia</i>	<i>Saudi Arabia</i>			Saudi Arabia
Sudan	<i>Sudan</i>						Sudan
Syria		<i>Syria</i>			<i>Syria</i>	Syria	
Tunisia		<i>Tunisia</i>			<i>Tunisia</i>	Tunisia	
Turkey		<i>Turkey</i>				Turkey	
United Arab Emirates			<i>United Arab Emirates</i>	<i>United Arab Emirates</i>			United Arab Emirates
Yemen	<i>Yemen</i>						Yemen

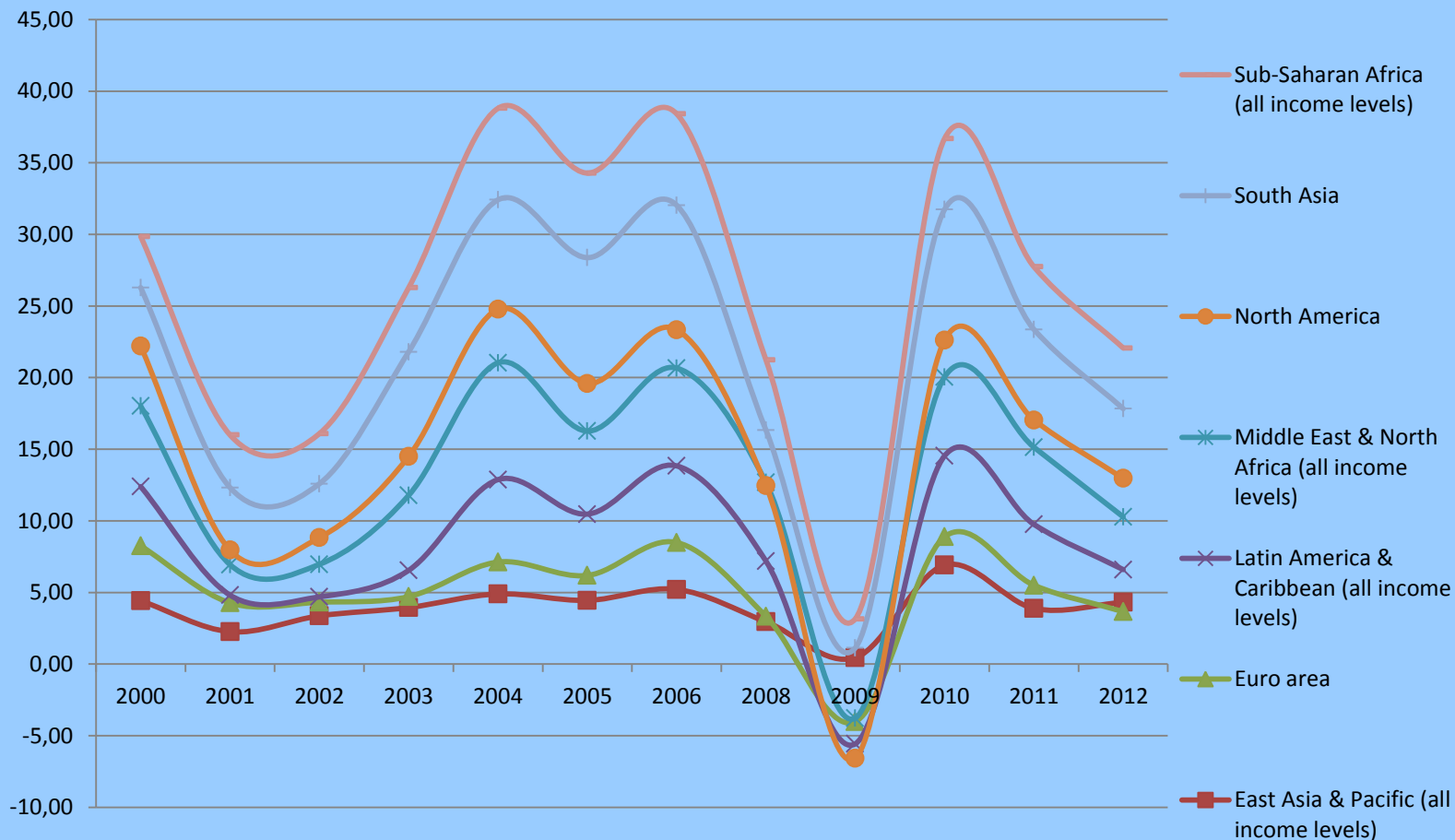
3. Performance: Ultimate Goals

GDP per capita in MENA and other Regions

GDP per Capita 2000- 2012 - Various Regions												
Region	2000	2001	2002	2003	2004	2005	2006	2008	2009	2010	2011	2012
East Asia & Pacific (all income levels)	3954	3644	3669	4001	4451	4699	4947	6301	6439	7415	8501	9039
Euro area	19722	19920	21557	26451	30117	31084	32798	40863	37241	36138	39119	36671
Latin America & Caribbean (all income levels)	4308	4148	3680	3733	4221	5035	5813	7740	7196	8759	9687	9575
Middle East & North Africa (all income levels)	3020	2958	2901	3190	3652	4299	4958	7092	6179	7084	8462	8875
North America	35202	35887	36730	38472	40859	43411	45744	48100	46293	48169	49932	51701
South Asia	451	454	470	540	617	697	785	985	1068	1289	1416	1396
Sub-Saharan Africa (all income levels)	516	483	501	623	756	861	976	1224	1126	1322	1438	1434

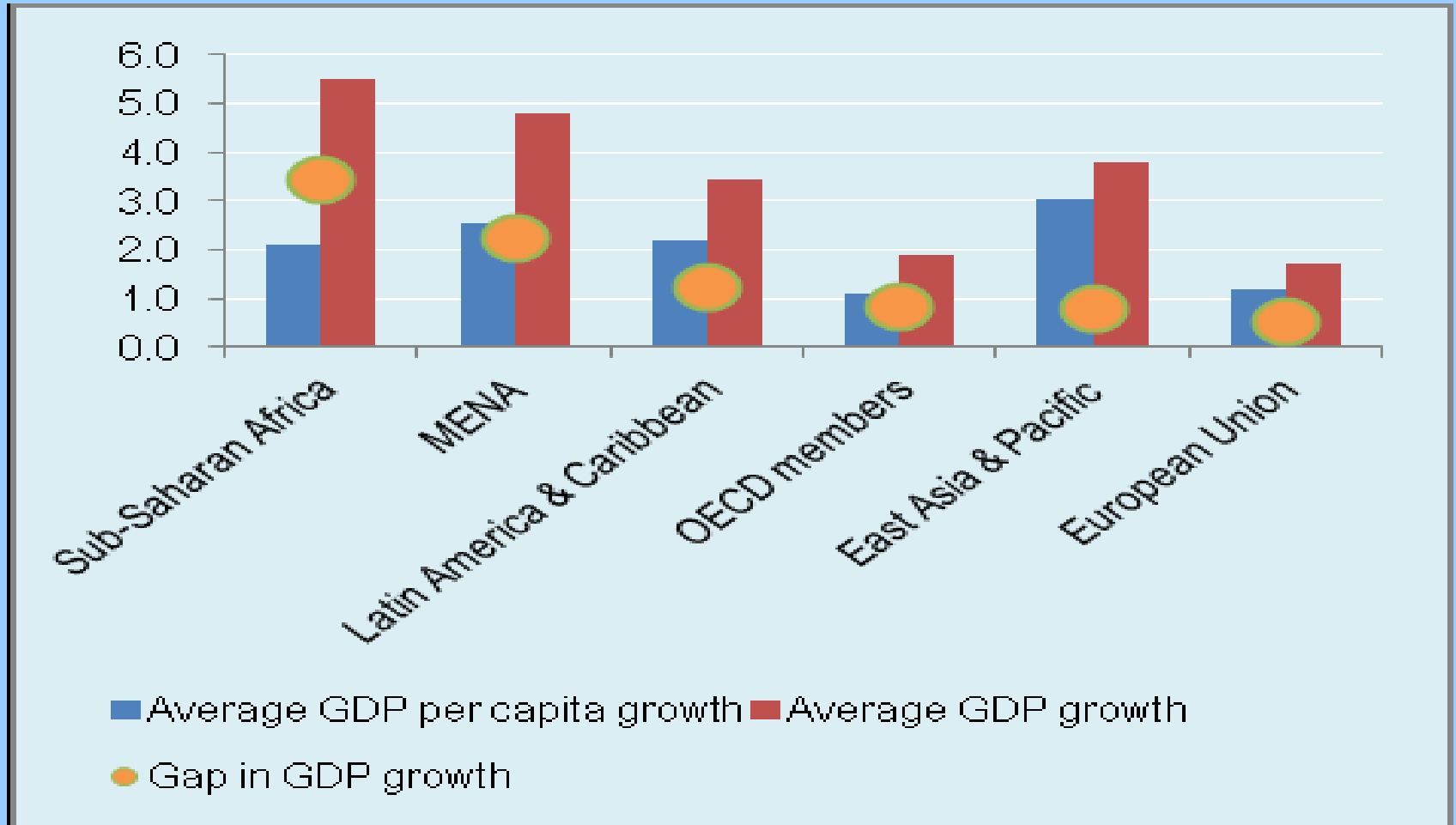
Source: World Bank, World Development Indicators

GDP Annual Growth by Region



Sources: World Bank - WDI

GDP and GDP per capita Growth 2000–10 by Region



Source: World Bank 2011

GDP and GDP per Capita

- High GDP growth rates have not been reflected in GDP per capita growth, which indicates that economic growth has not kept pace with population growth.
- Economic growth during 2000–10 in the MENA region has averaged **4.8** percent, whereas average GDP per capita growth for 2000–09 (the latest 11 years for which data are available) has been only **2.5** percent. This gap between GDP and GDP per capita growth is one of the highest in the world, below only sub-Saharan Africa.
- Performance among countries differs, with Tunisia, Morocco, and Lebanon registering the lowest gaps between GDP and GDP per capita growth, and Iraq, the United Arab Emirates, and Yemen registering the widest gaps.

Human Development Index and its Components

Human Development Index (HDI) and its Components										
HDI						GDP pc Index				
	1990	1995	2000	2005	2011	1990	1995	2000	2005	2011
Mena Low	0.3	0.32	0.36	0.4	0.43	0.32	0.36	0.38	0.4	0.43
Mena Mid	0.52	0.56	0.61	0.64	0.66	0.55	0.56	0.58	0.59	0.61
Mena High	0.7	0.72	0.73	0.75	0.78	0.78	0.78	0.78	0.78	0.8
Africa	0.38	0.38	0.37	0.4	0.43	0.34	0.32	0.33	0.34	0.37
Asia	0.47	0.52	0.55	0.59	0.63	0.39	0.43	0.46	0.5	0.56
LAC	0.62	0.64	0.67	0.7	0.73	0.6	0.61	0.62	0.63	0.65
Oceania	0.78	0.79	0.8	0.81	0.82	0.7	0.71	0.72	0.72	0.73
Europe	0.76	0.78	0.81	0.84	0.85	0.75	0.73	0.75	0.77	0.78
North America	0.87	0.88	0.9	0.9	0.91	0.82	0.83	0.86	0.87	0.87
Education Index						Health Index				
Mena Low	0.14	0.18	0.21	0.24	0.27	0.53	0.56	0.6	0.64	0.68
Mena Mid	0.38	0.43	0.49	0.54	0.57	0.7	0.75	0.79	0.81	0.84
Mena High	0.54	0.58	0.62	0.65	0.69	0.78	0.8	0.82	0.84	0.86
Africa	0.32	0.36	0.35	0.39	0.41	0.46	0.46	0.46	0.49	0.54
Asia	0.42	0.45	0.48	0.53	0.56	0.71	0.73	0.74	0.76	0.79
LAC	0.52	0.56	0.61	0.65	0.69	0.76	0.79	0.82	0.84	0.86
Oceania	0.81	0.84	0.83	0.84	0.84	0.83	0.85	0.87	0.89	0.9
Europe	0.69	0.76	0.8	0.84	0.86	0.86	0.87	0.89	0.91	0.93
North America	0.91	0.93	0.93	0.93	0.94	0.87	0.89	0.9	0.91	0.93

Source: UNDP 2012

Human Development Index

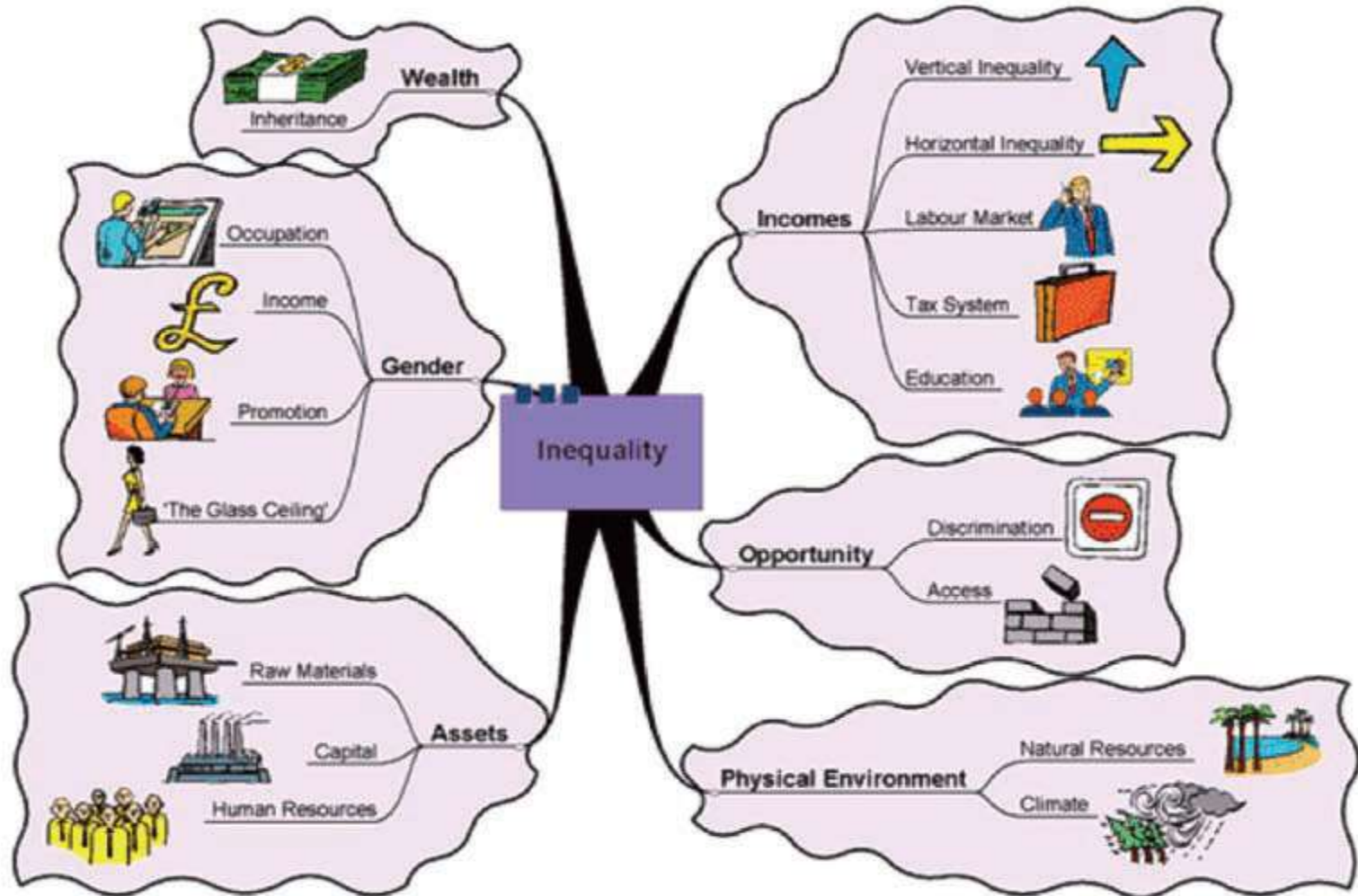
The Human Development Report introduces a new way of measuring development by combining indicators of **life expectancy, educational attainment and income into a composite human development index, the HDI.**

The breakthrough for the HDI was the creation of a **single statistic**, which was to serve as a frame of reference for both social and economic development. The HDI sets a minimum and a maximum for each dimension, called goalposts, and then shows where each country stands in relation to these goalposts, expressed as a value between 0 and 1.

Inequality

Equal Opportunities or Equal Outcome?

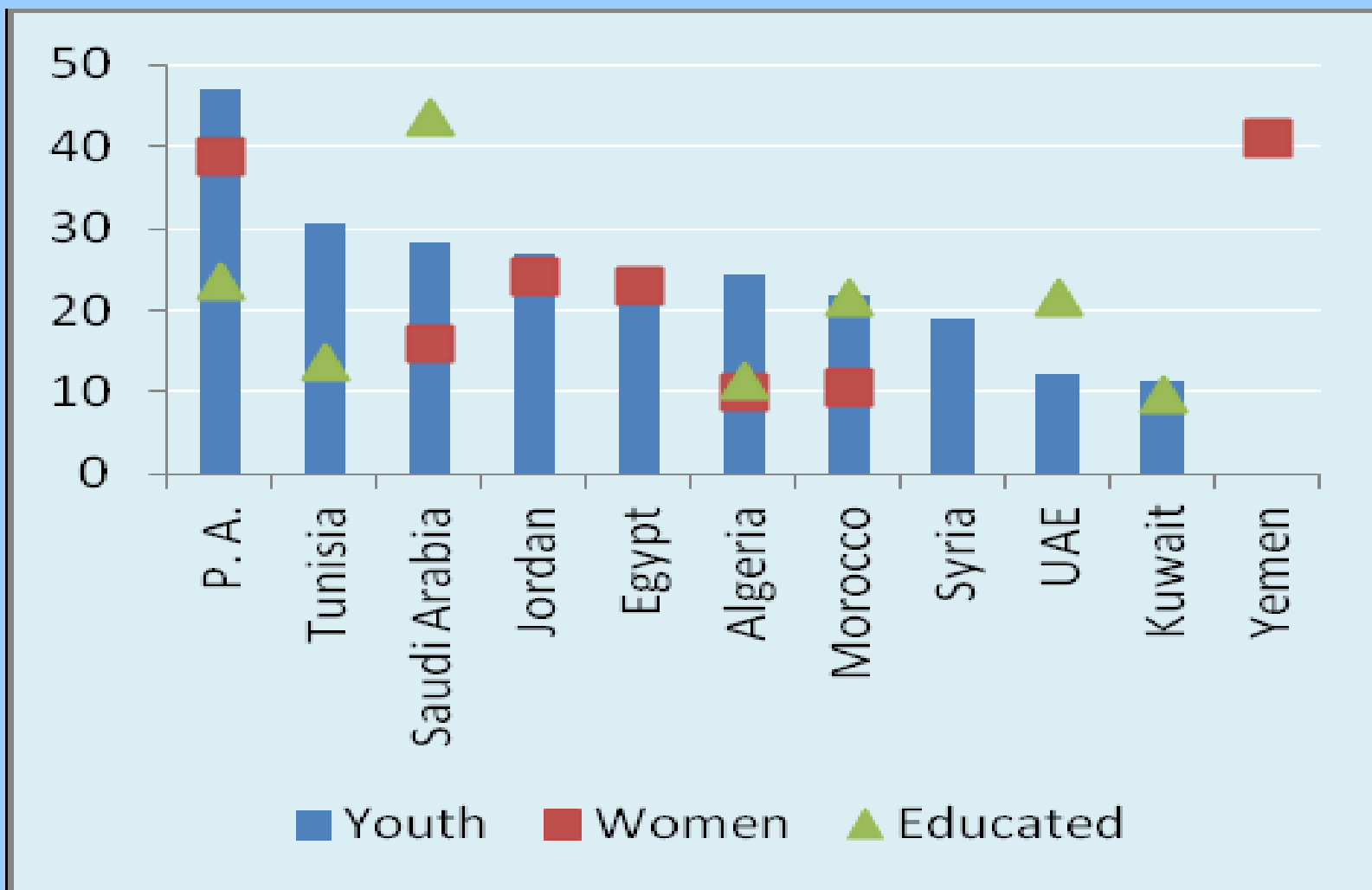
Dimension of Inequality



Source:

<http://www.bized.co.uk/educators/1619/economics/development/activity/inequality.htm>

Unemployment in % among youth, women, and the educated- 2010



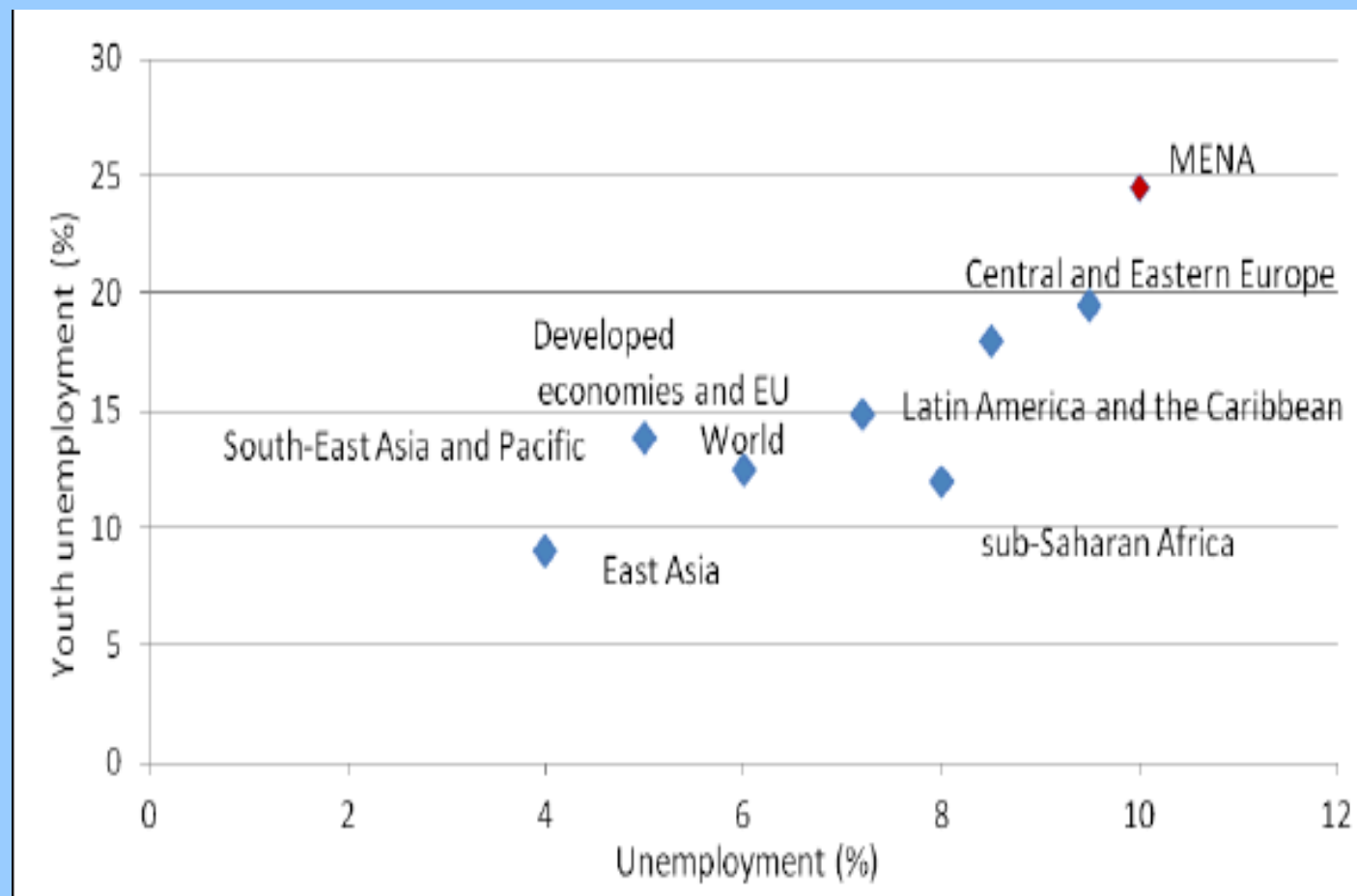
Source: World Bank 2011

Youth Labor Participation Rate

Youth Labor Participation Rate	Total(%)			Male(%)			Female(%)		
	2000	2010	2015	2000	2010	2015	2000	2010	2015
World	53.8	50.9	50.2	62.5	58.9	58.2	44.7	42.4	41.6
Developed Economies & EU	53.1	50.2	50.2	55.9	52.6	52.5	50.3	47.7	47.9
Central and South Eastern Europe (non EU & CIS)	42.4	41.7	40.8	48.9	47.7	47.0	35.7	35.5	34.3
East Asia	67.2	59.2	56.9	65.8	57.0	55.0	68.7	61.6	59.2
South-East Asia & the Pacific	55.8	51.3	50.6	63.5	59.1	57.9	48.0	43.3	42.9
South Asia	48.0	46.5	46.3	66.1	64.3	64.0	28.5	27.3	27.2
Latin America & the Caribbean	54.2	52.1	51.4	66.5	61.3	59.3	41.7	42.7	43.5
Middle East	36.9	36.3	34.7	52.6	50.3	48.1	20.2	21.5	20.5
North Africa	39.4	37.9	36.5	53.4	52.5	50.2	25.1	22.9	22.3
Sub-saharan Africa	57.8	57.5	57.4	64.1	62.7	62.1	51.4	52.2	52.7

Source: ILO, Economically Active Population Estimates and Projections, 5th Edition, revision 2009.

Youth Unemployment in the MENA Region: Determinants and Challenges



IMF 2010

Inequality-Adjusted Human Development Index

Inequality-adjusted Human Development Index - 2011								
Regions	Inequality-adjusted HDI		Inequality-adjusted life expectancy Index		Inequality-adjusted education Index		Inequality-adjusted income Index	
	Value	Overall loss (%)	Value	Loss (%)	Value	Loss (%)	Value	Loss (%)
Sub-Saharan Africa	0.303	34.500	0.331	39.012	0.276	35.555	0.306	28.400
South Asia	0.393	28.407	0.529	26.941	0.266	40.857	0.430	15.079
MENA Countries	0.472	26.400	0.654	17.979	0.307	40.800	0.524	17.800
East Asia and the Pacific	0.528	21.300	0.709	14.261	0.477	21.900	0.435	26.800
Europe and Central Asia	0.655	12.736	0.715	11.705	0.681	10.704	0.578	15.720
Latin America and the Caribbean	0.540	26.101	0.743	13.425	0.528	23.206	0.401	39.294
Inequality-adjusted HDI (IHDI): Human Development Index (HDI) value adjusted for inequalities in the three basic dimensions of human development, i.e., a long and healthy life, knowledge and a decent standard of living.								
Source: UNDP 2011								

Gender Inequality

Gender Inequality Index and Related Indicators								
Regions	Gender Inequality Index	Maternal Mortality Ratio	Adolescent Fertility Rate	Seats in National Parliament (% Female)	Population with at Least Secondary Education		Labor Force Participation Rate	
					Female	Male	Female	Male
Sub-Saharan Africa	0.610	618.928	119.739	19.763	22.155	34.936	62.853	81.188
South Asia	0.601	251.866	77.401	12.450	27.348	49.185	34.566	81.157
MENA Countries	0.563	191.758	44.357	11.969	32.857	46.230	26.017	77.112
East Asia and the Pacific	..	79.430	19.753	20.213	48.109	61.285	64.235	80.348
Europe and Central Asia	0.311	29.075	28.033	13.363	78.038	83.326	49.669	67.759
Latin America and the Caribbean	0.445	79.872	73.743	18.732	50.506	52.173	51.740	79.938

Source:UNDP 2011 Report

Gender Inequality Index: A composite measure reflecting inequality in achievements between women and men in three dimensions: reproductive health, empowerment and the labor market.

Gender Inequality

Gender Inequality Index: A composite measure reflecting inequality in achievements between women and men in three dimensions: reproductive health, empowerment and labor market.

Maternal mortality ratio: Ratio of the number of maternal deaths to the number of live births in a given year, expressed per 100,000 live births.

Adolescent fertility rate: Number of births to women ages 15–19 per 1,000 women ages 15–19.

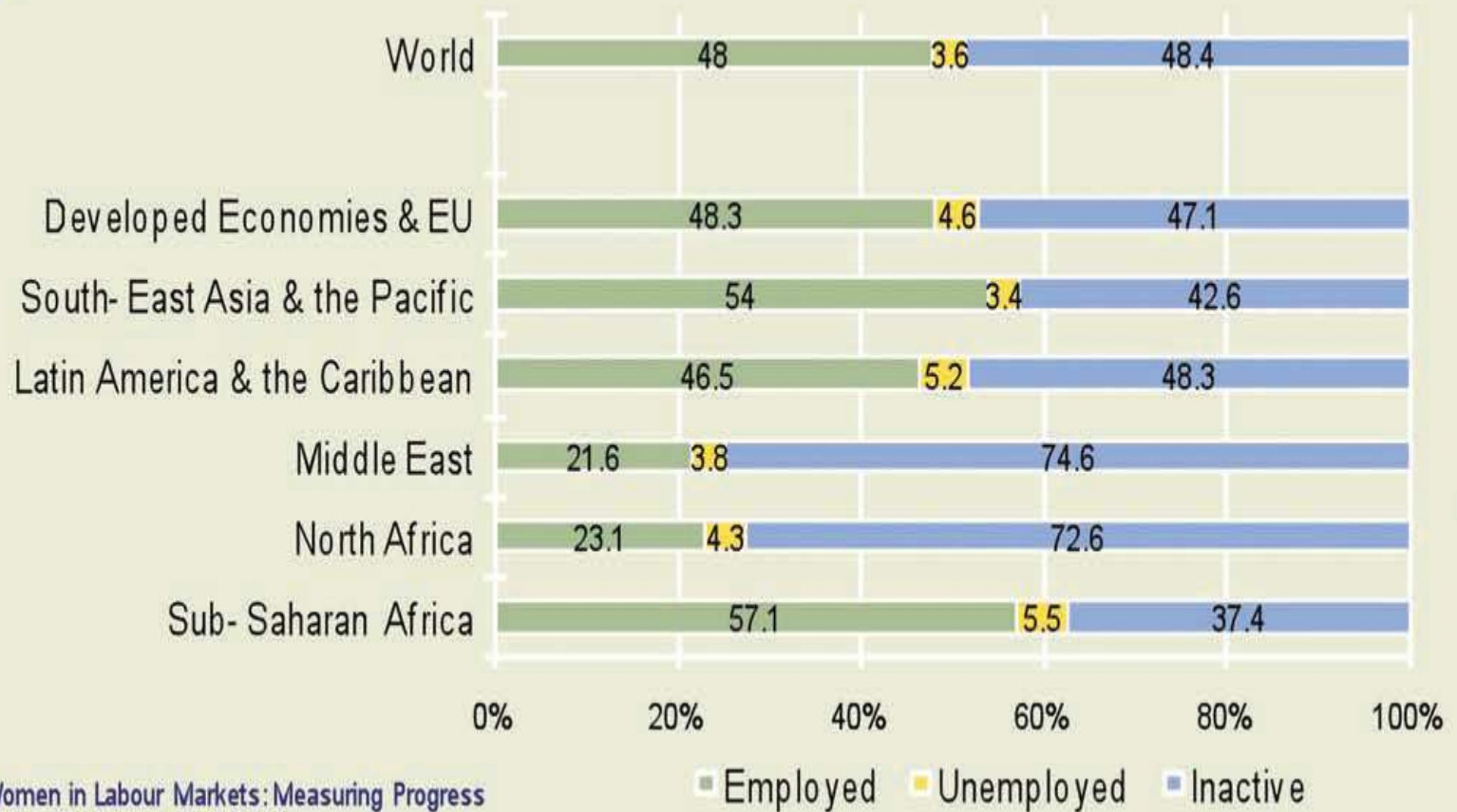
Seats in national parliament: Proportion of seats held by women in a lower or single house or an upper house or senate expressed as percentage of total seats.

Population with at least secondary education: Percentage of the population ages 25 and older who reached at least a secondary level of education.

Labor force participation rate: Proportion of a country's working-age population that engages in the labor market, either by working or actively looking for work, expressed as a percentage of the working-age population.

Female Participation in the Workforce

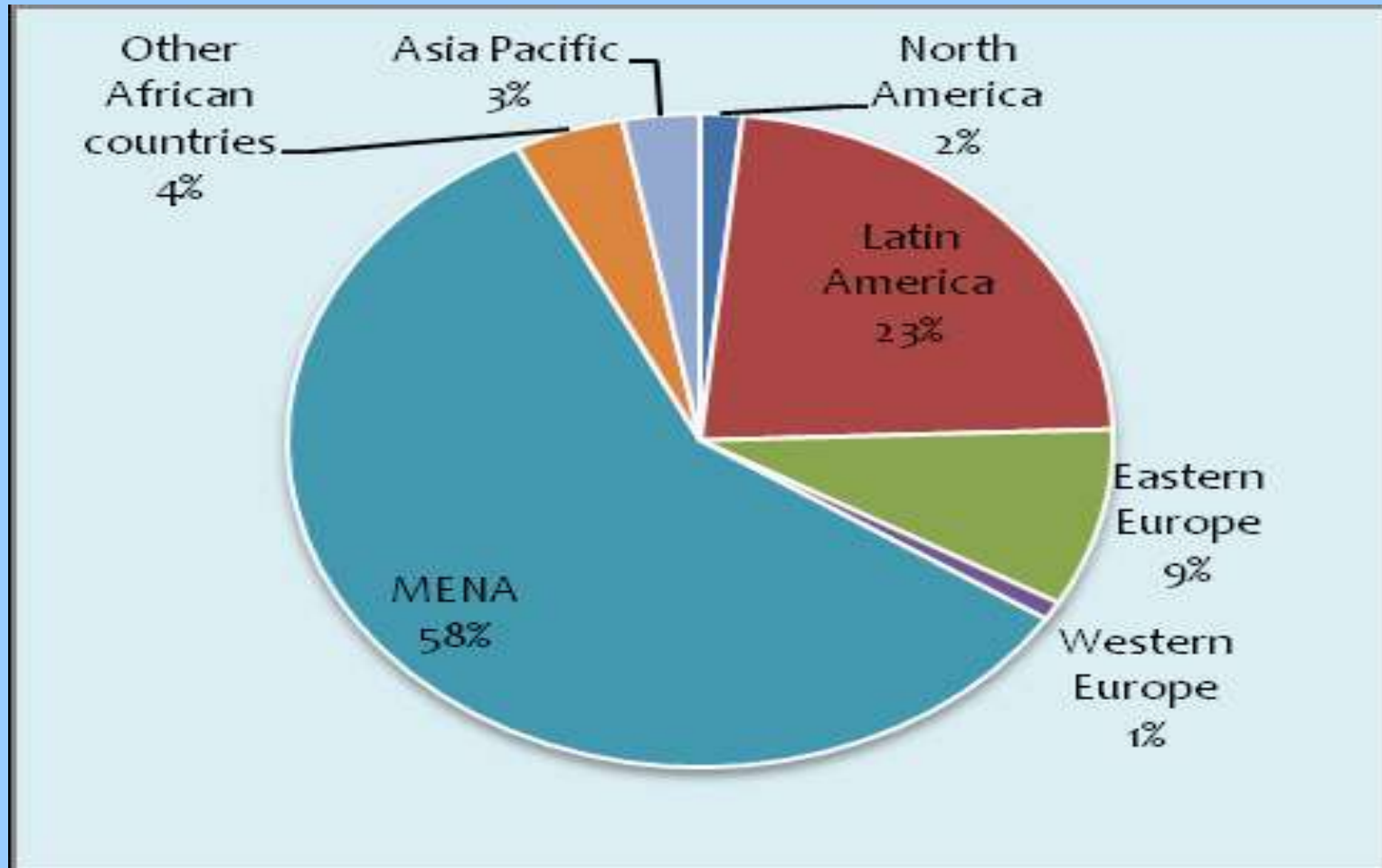
Female



Source: Women in Labour Markets: Measuring Progress and Identifying Challenges, ILO, 2010

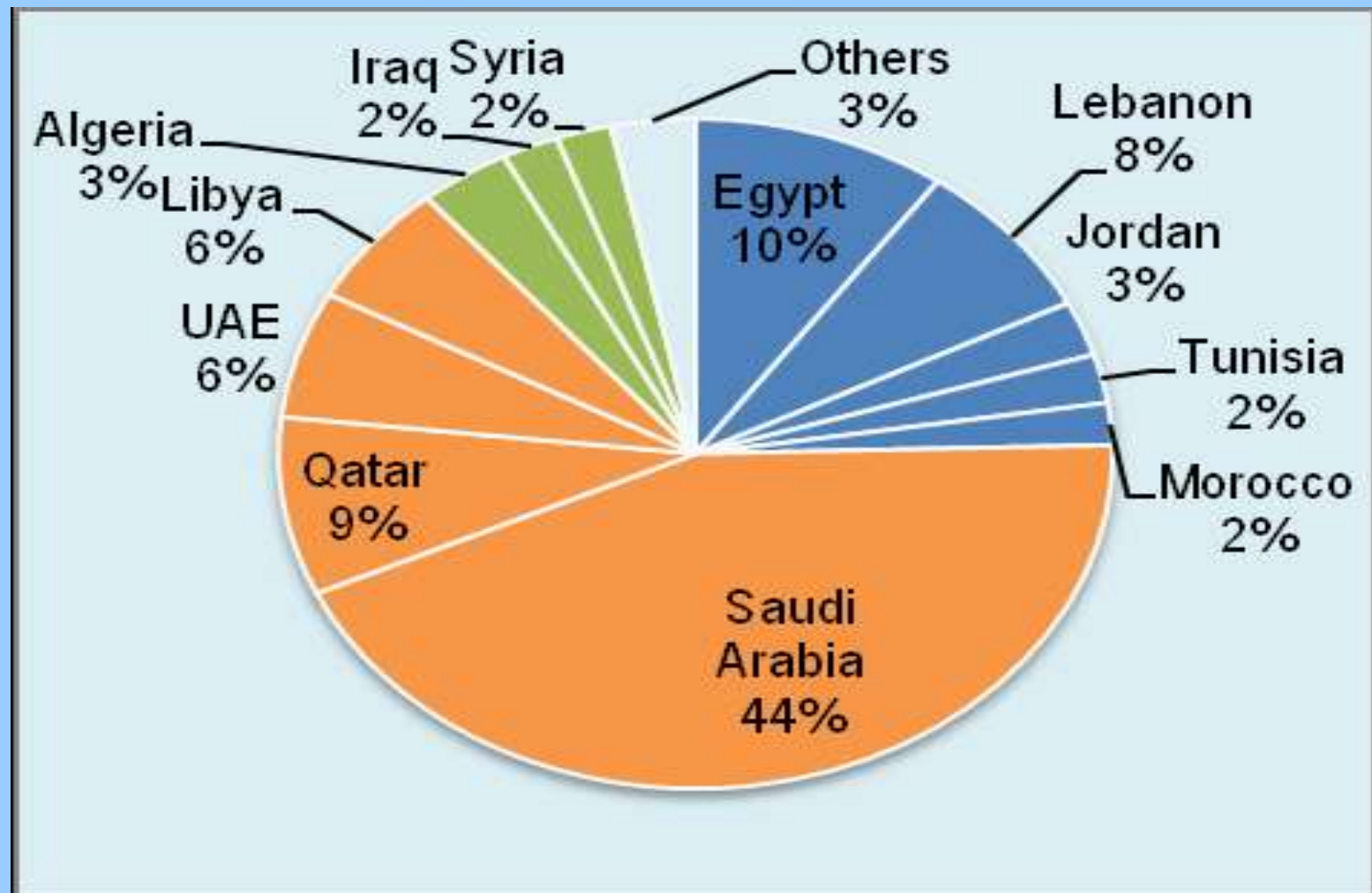
**4. “Intermediate” Variables:
Factors
that Affect Performance**

World Proven Crude Oil Reserves by Region, 2010



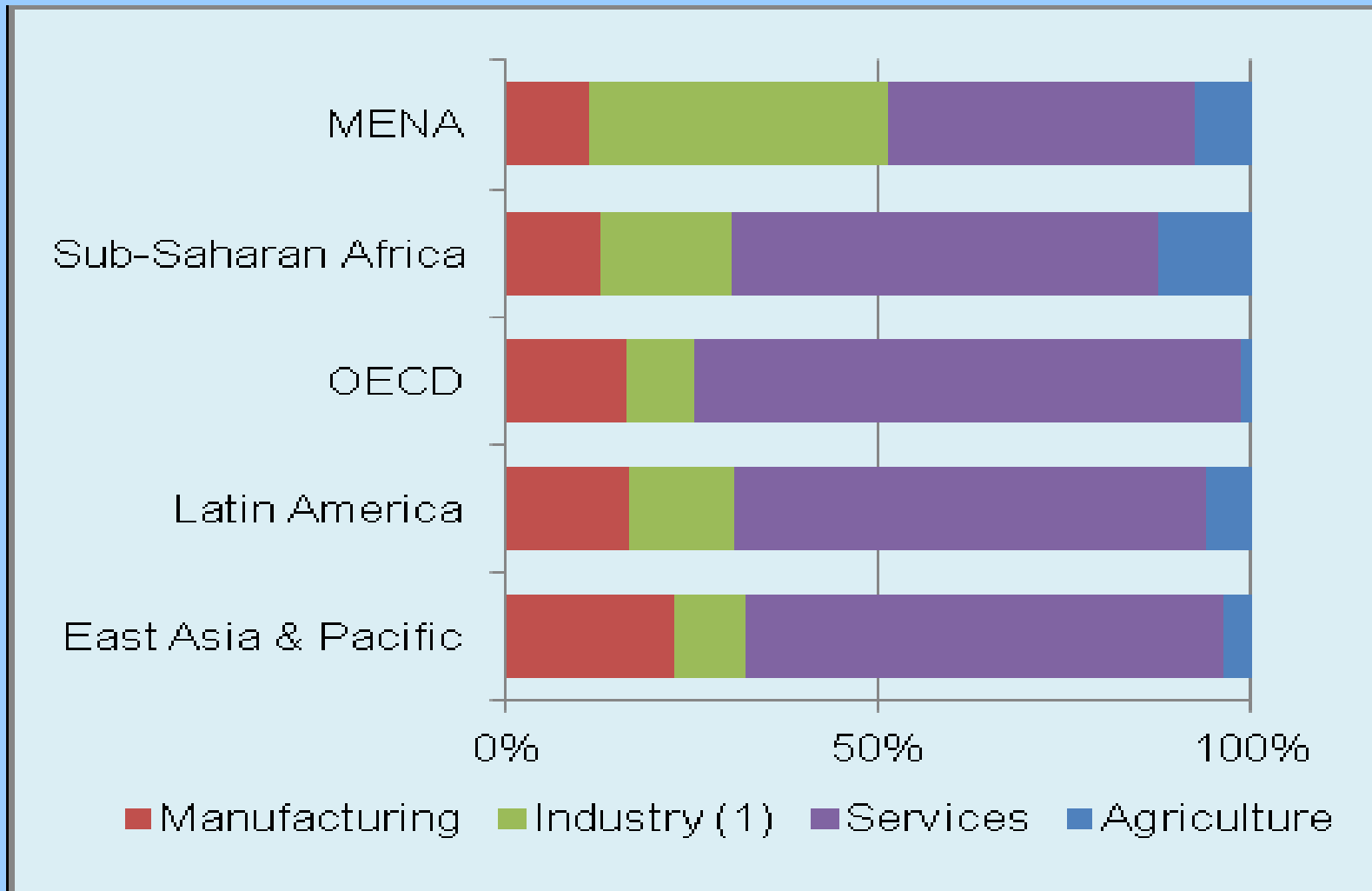
Source: OPEC 2010.

FDI Inflows to the MENA Region, 2010



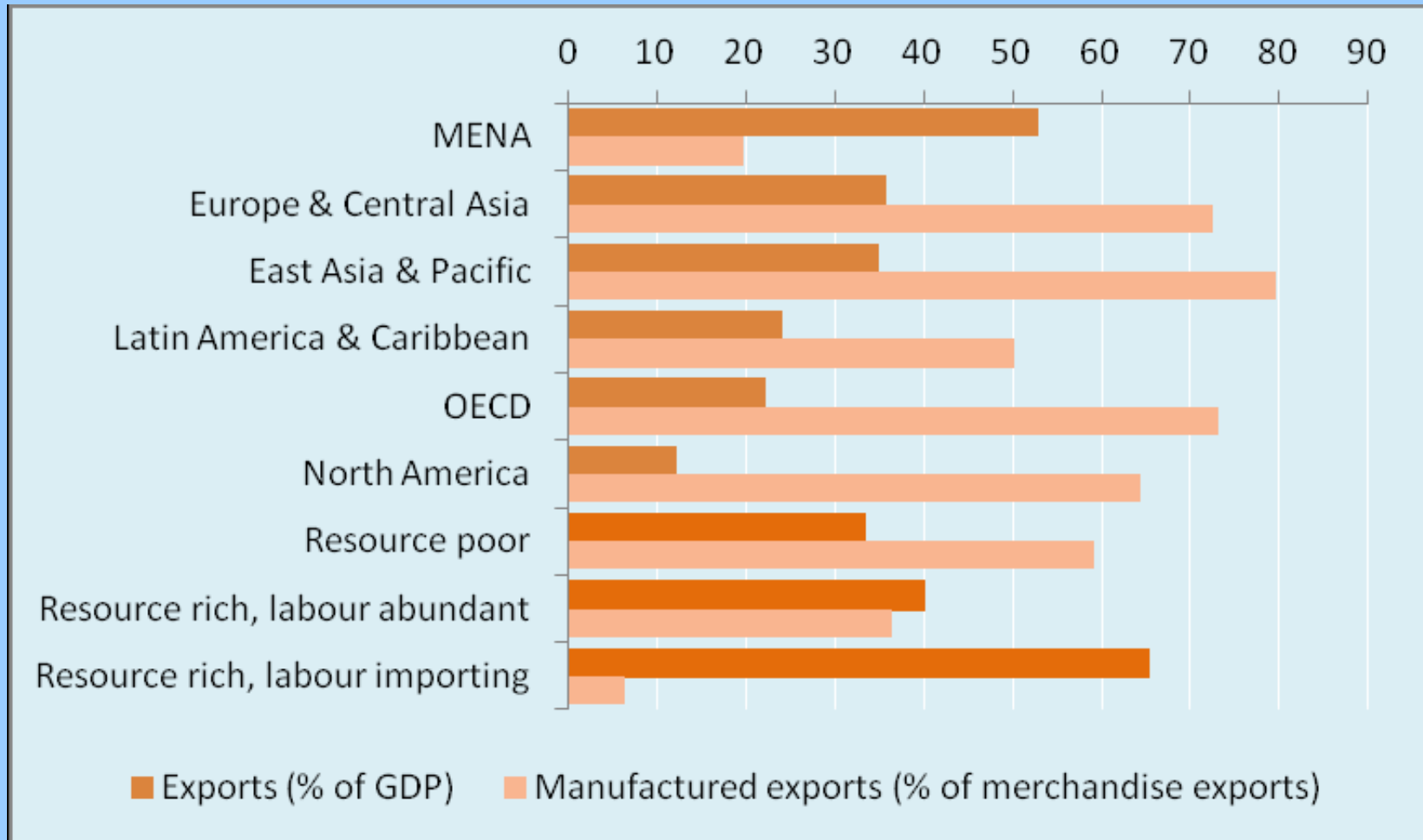
Source: UNCTAD 2011.

Value Added in Selected Regions



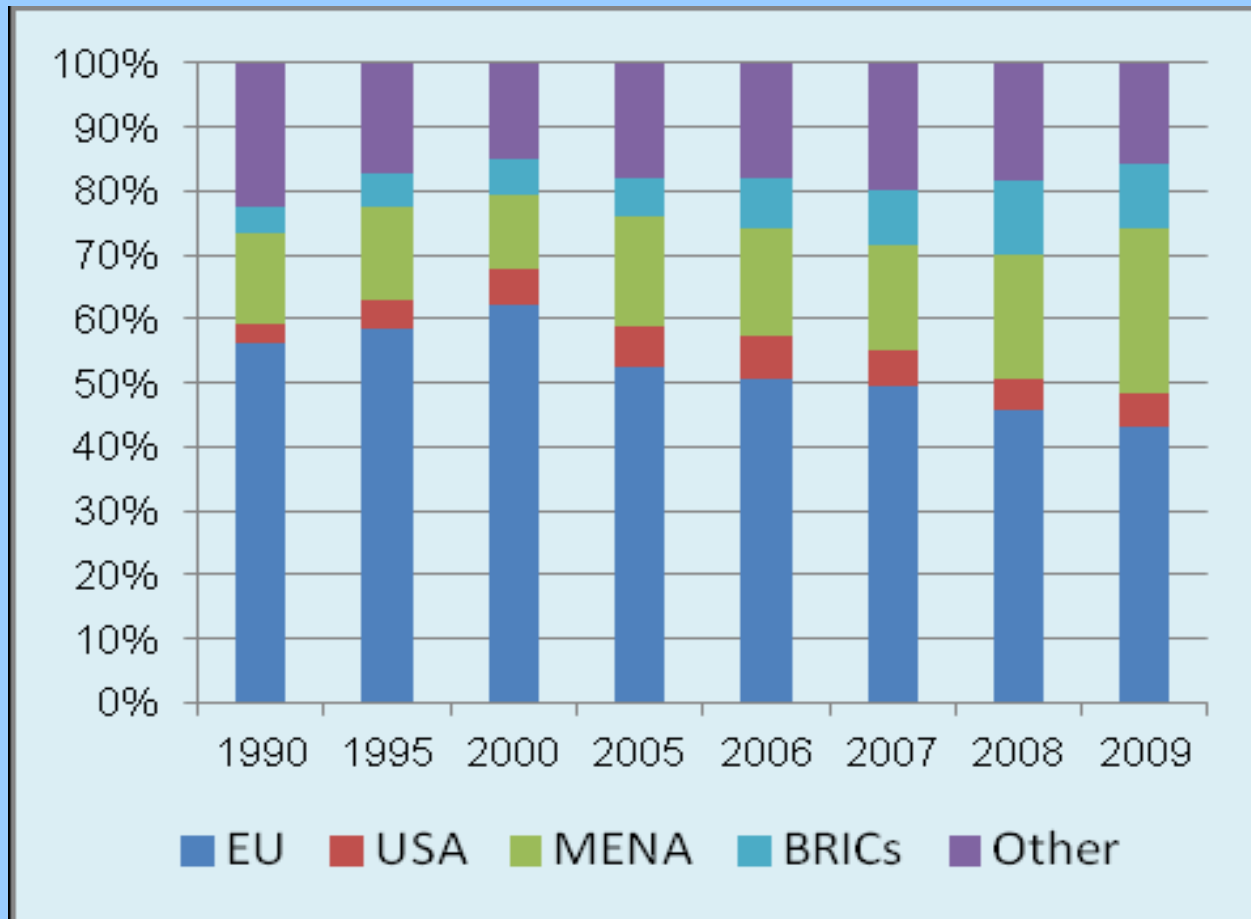
Source: World Bank 2010 and Klapper and Love 2010

Exports as a share of GDP are high in MENA, but manufactured exports are comparatively low



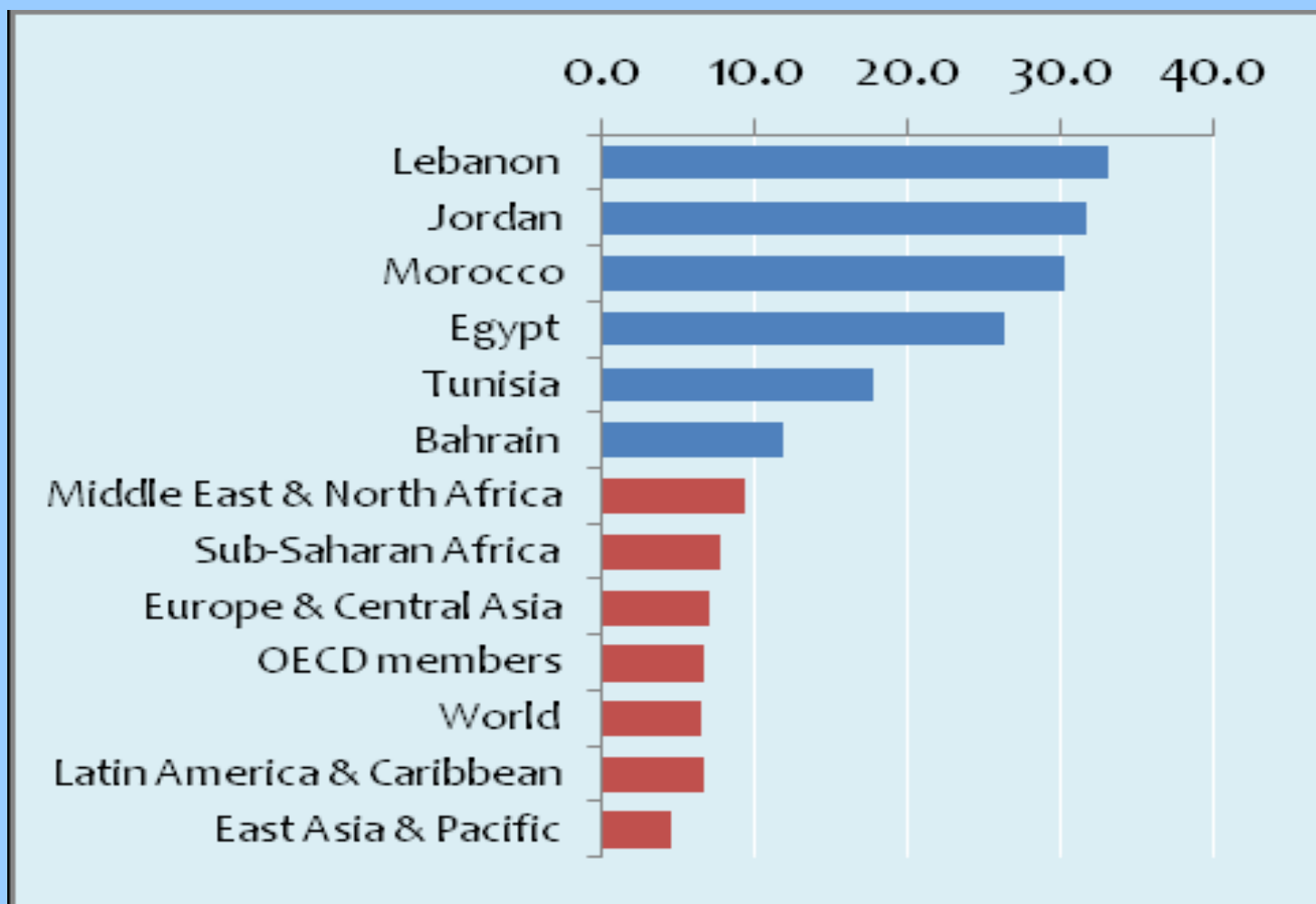
Source: World Bank 2011

Resource-poor Countries' main Export Market is the EU



Source: IMF 2011

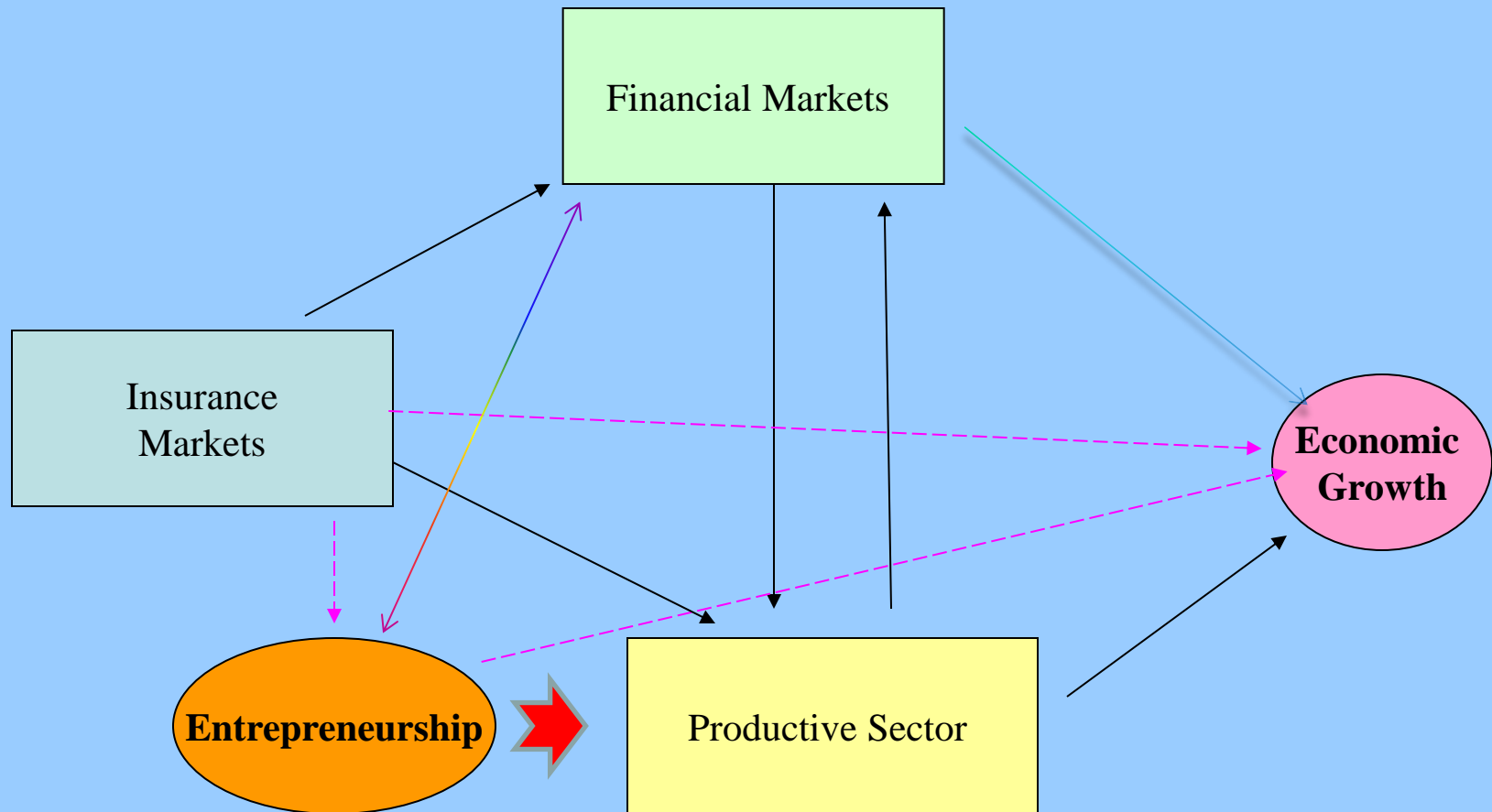
International Tourism Receipts as percent of Total Exports



Sources: IMF 2011d and World Bank 2011

5. Entrepreneurship and Finance

Framework for Entrepreneurship and Insurance



The Process of Development

- According to Schumpeter (1934), the **entrepreneur** is the innovator who **implements change and produces growth** by initiating new combinations, which can take several forms:
 - (1) the introduction of a new good or quality thereof,
 - (2) the introduction of a new method of production,
 - (3) the opening of a new market,
 - (4) the conquest of a new source of supply of new materials or parts,
or
 - (5) carrying out the new organization of any industry.

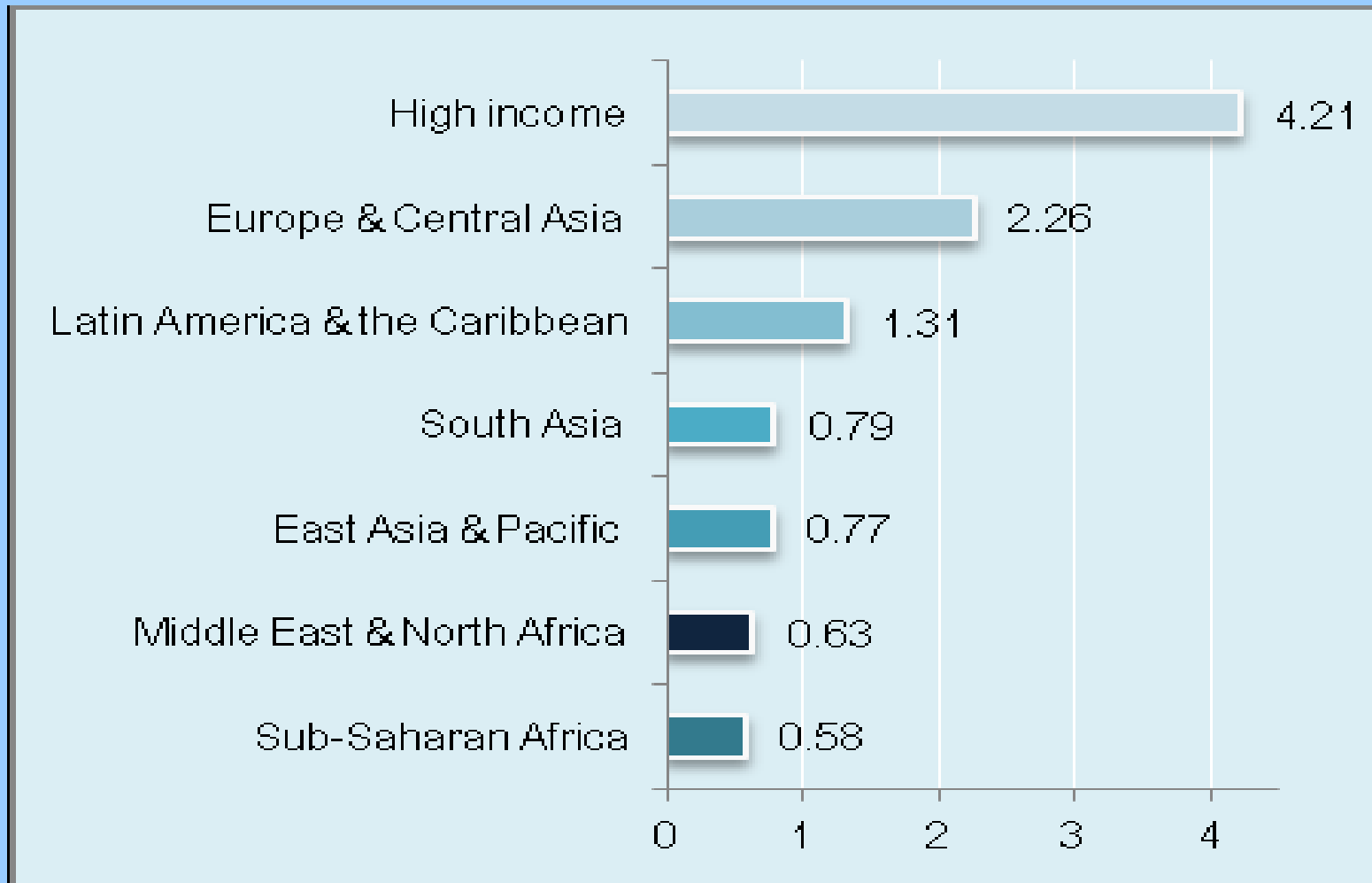
- The basic contention is that small firms, start-ups - home of the independent entrepreneur and the independent inventor- constitute the primary source of the technical ideas and innovations that serve as the foundation for the unprecedented growth performance of the world's industrial economies.
 - Baumol W., The Free-Market Innovation Machine: Analyzing the Growth Miracle of Capitalism, Princeton: Princeton University Press, 2002

The Process of Development

Role of Financial Markets and financial services

- Allocation of credit according to efficiency criteria, rewarding the “creative destruction” of the Schumpeterian entrepreneur, and therefore facilitating opportunities and economic growth.
- For entrepreneurs and businessmen, access to finance and availability of financial services, including insurance, is crucial.
- Financial markets and services have to be available and provide an effective service to scrutinize projects: the greater the effectiveness, the more uncertainty will be reduced.

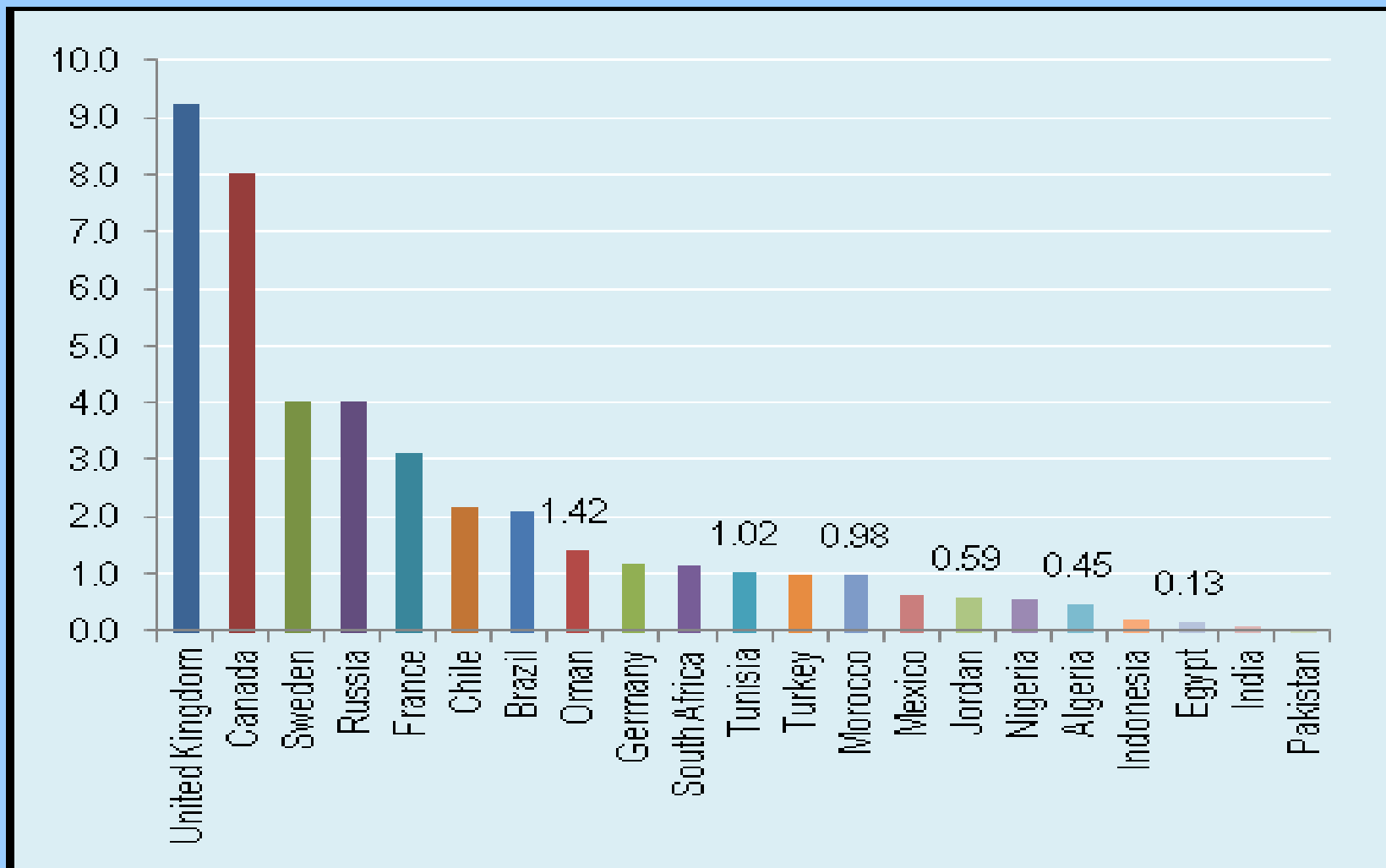
Firm Entry Density by Region 2004–2009 averages



Entry density rate is the number of newly registered corporations divided by the number of total registered corporations

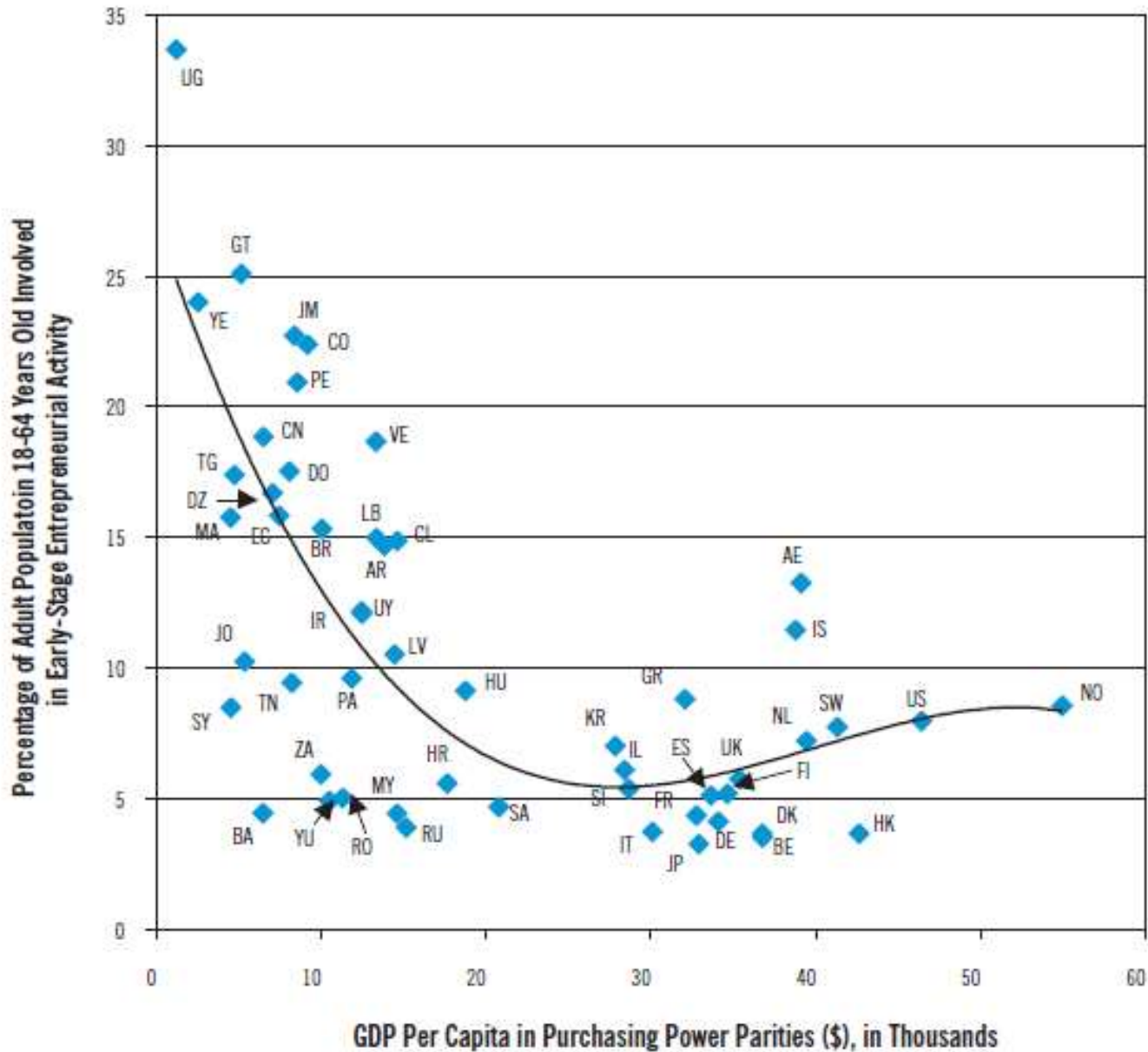
Source: World Bank 2010, and Klapper and Love 2010

Firm Entry Density in Selected Economies 2004–2009 Averages



Source: World Bank 2010, and Klapper and Love 2010

Total Early-Stage Entrepreneurial Activity in 2009



Source:
GEM
Global
Report
2009

The chart indicates that for countries with **low levels of per capita** income, the national economy is characterized by the existence of **many very small businesses**. As per capita income increases, industrialization and economies of scale allow larger and established firms to satisfy the increasing demand of growing markets and increase their relative role in the economy.

An important factor for achieving growth is the presence of **macro-economic and political stability, which is reflected by the development of strong institutions, commonly accepted norms of behavior, transparent and respected legal and regulatory systems.**

The increase in the role of large firms may be accompanied by a reduction in the number of new businesses, as a growing number of people find stable employment in large companies.

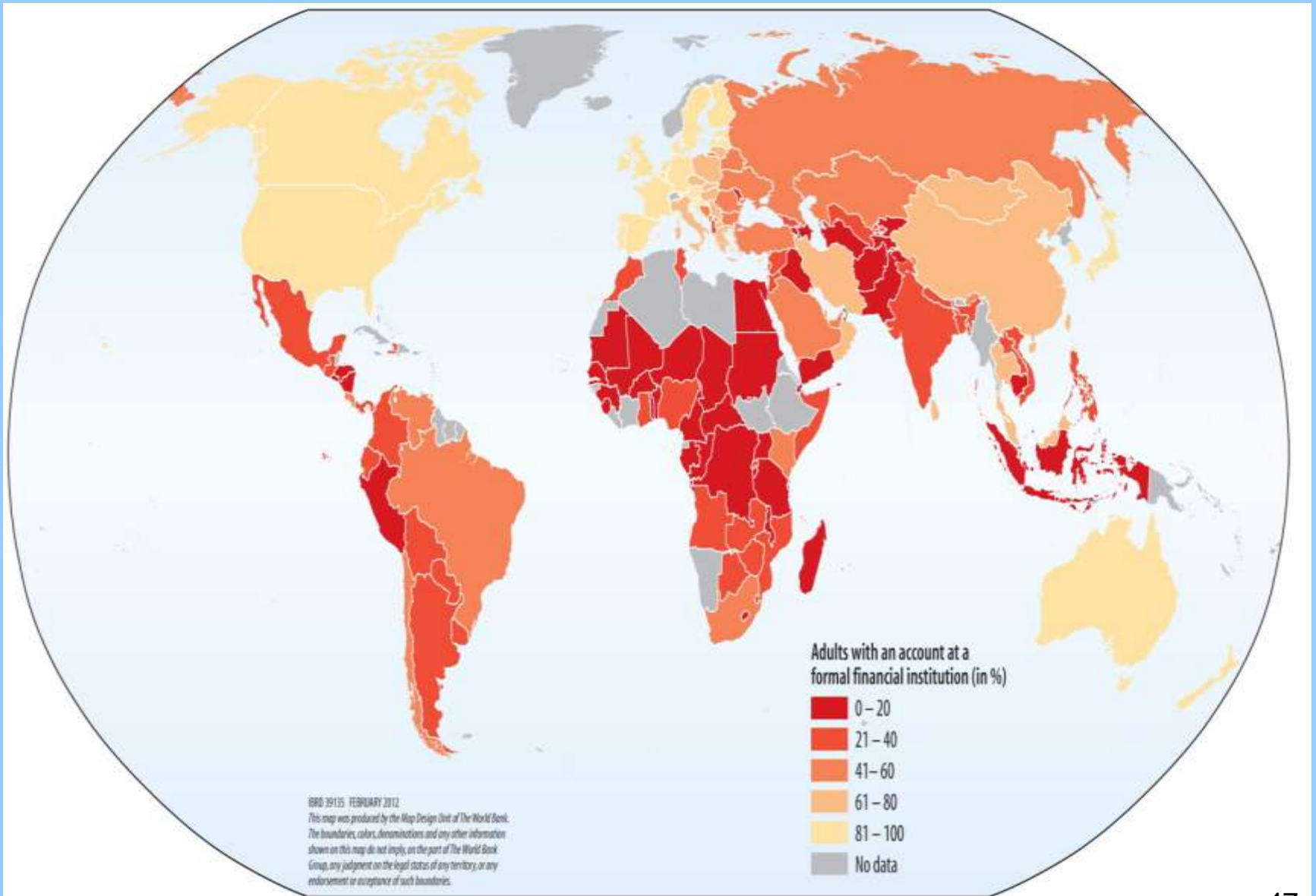
Domestic Credit Provided to the Private Sector

Domestic Credit provided by financial sector (% of GDP)													
Country Name	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
East Asia & Pacific (all income levels)	226.25	218.77	221.61	225.96	217.32	213.08	200.46	189.82	187.83	206.87	202.39	202.56	206.54
Latin America & Caribbean (all income levels)	44.78	44.20	47.62	47.91	47.18	48.75	54.42	58.65	61.33	63.47	66.62	70.56	74.80
Middle East & North Africa (all income levels)	53.67	57.83	57.25	55.71	49.27	43.53	40.63	42.24	37.12	47.06	40.30	41.03	38.98
Sub-Saharan Africa (all income levels)	70.53	79.92	67.95	77.01	80.57	80.99	78.39	77.21	62.95	77.63	80.39	76.45	76.65
South Asia	48.41	50.47	53.72	52.82	55.14	56.40	57.71	58.32	64.30	66.04	68.13	69.41	71.10
Euro area	119.31	120.03	119.08	121.07	122.21	127.25	131.16	138.21	142.65	152.46	155.83	153.26	153.35
North America	185.79	198.85	192.16	205.54	211.50	215.22	225.73	228.38	213.12	231.37	228.11	227.88	229.87

Access Indicators

Access Indicators by Region			
Regions	Banks Deposits Accounts per 1000 adults	Bank Loan Accounts per 1000 adults	Private Credit as % of GDP
Sub-Saharan Africa	315.5	87.5	23.7
South Asia	653.8	54.2	43.9
Middle East and North Africa	744	213.3	50.6
Europe and Central Asia	1395.4	325.2	45.8
East Asia and Pacific	1169.9	343.9	58.4
Latin America and Caribbean	1227.5	366.8	44.7
High Income non- OECD	1865	851.5	83.4
High Income OECD	2383.7	702.4	130.8
<i>Source: CGCP and World Bank Financial Access 2010. International Financial Statistics</i>			

Account Penetration

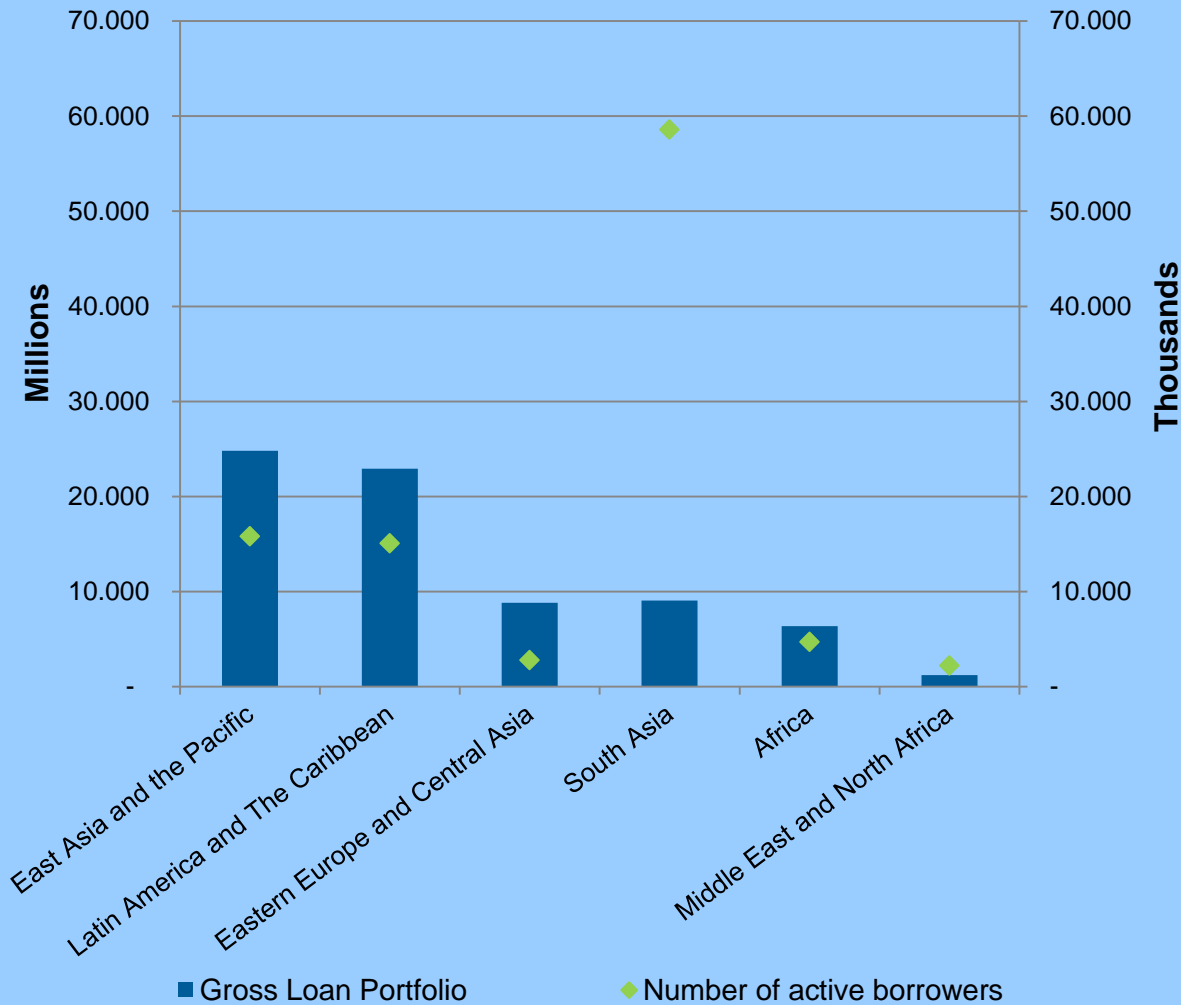


Micro Finance Indicators

Microfinance Scale in the Region					
Regions	MFI Providers	Number of Active Borrowers	Active Borrowers/Working Age Population(%)	Gross Loan Portfolio (GLP)	GLP/Total Credit
Sub-Saharan Africa	208	6,732,155.00	1.48	3,162,740,041.00	4.71
South Asia	148	39,274,147.00	5.9	4,293,510,584.00	4.72
Middle East and North Africa	40	2,807,116.00	1.99	1,505,414,132.00	0.47
Europe and Central Asia	263	2,603,513.00	4.11	9,375,908,169.00	5.37
East Asia and Pacific	160	11,294,660.00	4.74	5,195,228,561.00	6.1
Latin America and Caribbean	327	12,781,340.00	4.93	15,334,944,785.00	7.14

Source : CGCP and World Bank Financial Access 2010. International Financial Statistics

Lowest Outreach in MENA



In terms of total outreach and scale, the Arab region recorded the lowest compared to its global peers. The Arab region recorded the lowest compared to its global

The region has among the lowest average loan balances, at 16 percent of GDP per capita, following South Asia and East Asia.

<http://www.mixmarket.org/profiles-reports/crossmarket-analysis-report?rid=MwzqVtDK>

Insurance

Life Insurance Growth, Penetration and Density by Region					
Region	Premiums in US\$ m (2009)	Real Growth 2009	Share of World Markets in %	Premiums in % of GDP 2009	Premiums per capita in US\$ (2009)
America	579,626.00	-12.20	24.86	2.97	6,315.00
North America	536,001.00	-13.50	22.99	3.44	1,572.80
Latin America and Caribbean	43,625.00	7.80	1.87	1.11	75.60
Europe	953,515.00	3.50	40.90	4.52	1,111.00
Western Europe	935,520.00	4.10	40.12	5.24	1,811.00
Central and Eastern Europe	17,995.00	-20.10	0.77	0.58	55.80
Asia	732,267.00	1.80	31.41	4.51	1,803.00
Japan and newly Industrialized Asian Economies	538,067.00	-1.20	23.08	7.97	2,553.80
South and East Asia	187,355.00	11.40	8.04	2.45	52.90
MENA Countries	6,845.00	0.50	0.29	0.37	22.10
Africa	32,564.00	-15.00	1.40	2.15	32.30
Oceania	33,592.00	-19.40	1.44	3.12	930.70
World	2,331,566.00	-2.00	100.00	4.01	341.20
<i>Industrialized Countries</i>	2,046,957.00	-2.80	87.79	5.01	1,979.90
<i>Emerging Markets</i>	284,609.00	4.20	12.21	1.54	48.80
OECD	1,975,474.00	-3.20	84.73	4.69	1,606.60
G7	1,573,924.00	-3.20	67.51	5.06	2,131.80
Euroland	628,772.00	11.50	26.97	4.64	1,765.10
EU, 27 countries	906,784.00	3.50	38.89	5.22	1,720.10
NAFTA	543,690.00	-13.30	23.32	3.30	1,207.10
ASEAN	28,252.00	2.00	1.21	1.97	55.40

Source: Swiss.Re Sigma 2/2009

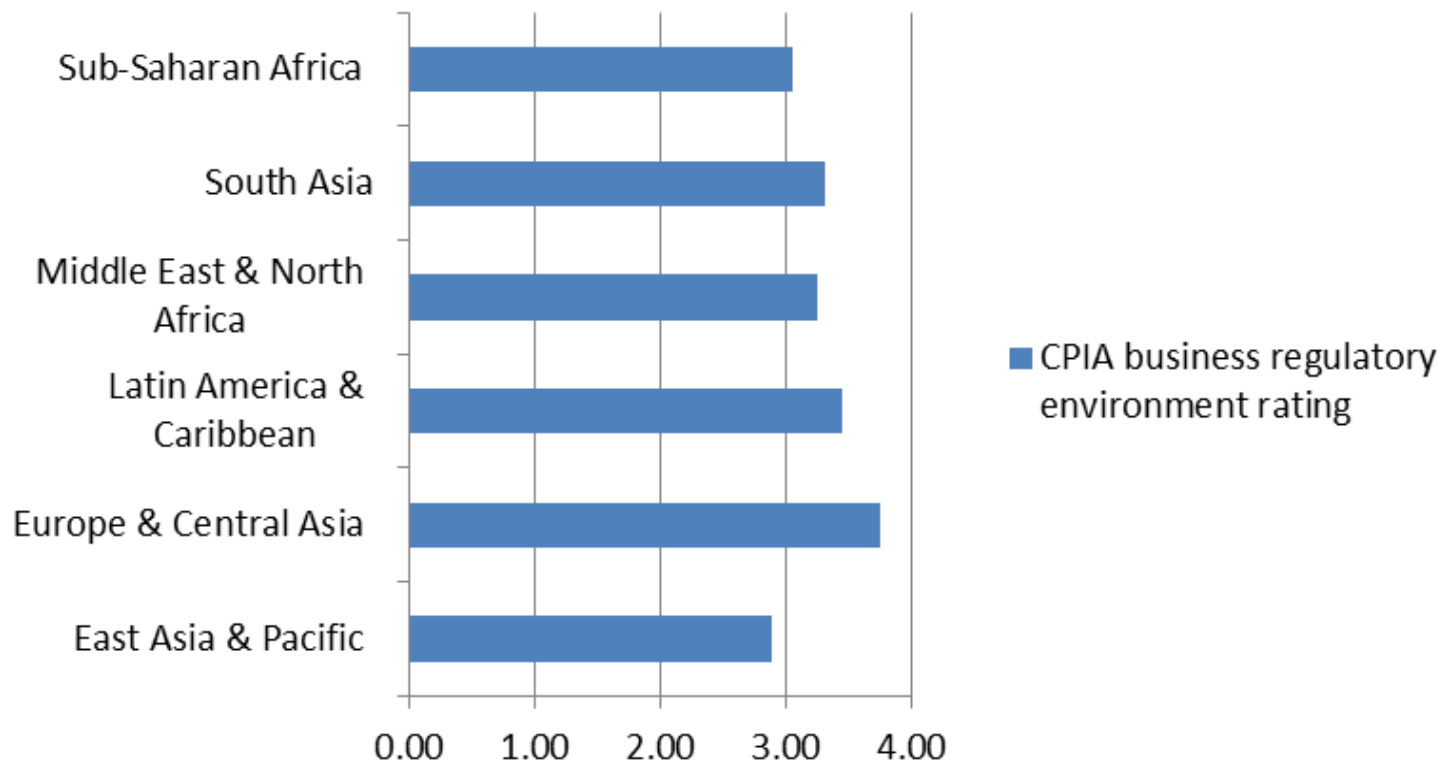
Technology Penetration Rates

2009	World	Western Europe	Sub Saharan Africa	North America	Middle East and North Africa	Latin America	East and Central Europe
Telephone main lines (per 100 people)	17.5	36.5	2.5	40.4	15.0	19.7	24.3
Mobile subscribers (per 100 people)	73.7	126.0	62.4	88.3	92.0	89.9	123.0
Internet users (per 100 people)	30.7	71.2	21.1	76.9	25.0	38.6	53.5
Broadband subscriber lines (per 100 people)	8.8	28.0	0.4	26.0	4.4	7.5	14.7
Personal computers (stock per 1,000 pop)	271.0	671.0	79.0	955.0	155.0	223.0	453.0

Source: Economist Intelligence Unit

Business Regulation

CPIA business regulatory environment rating



Corruption

Corruption remains a major issue in many MENA countries.....

Transparency International Rankings for 2011

Country Rank	Regional Rank	Country / Territory	CPI 2011 Score
22	1	Qatar	7.2
28	2	United Arab Emirates	6.8
36	3	Israel	5.8
46	4	Bahrain	5.1
50	5	Oman	4.8
54	6	Kuwait	4.6
56	7	Jordan	4.5
57	8	Saudi Arabia	4.4
73	9	Tunisia	3.8
80	10	Morocco	3.4
112	11	Algeria	2.9
112	11	Egypt	2.9
120	13	Iran	2.7
129	14	Syria	2.6
134	15	Lebanon	2.5
164	16	Yemen	2.1
168	17	Libya	2.0
175	18	Iraq	1.8

Source: Transparency International 2011

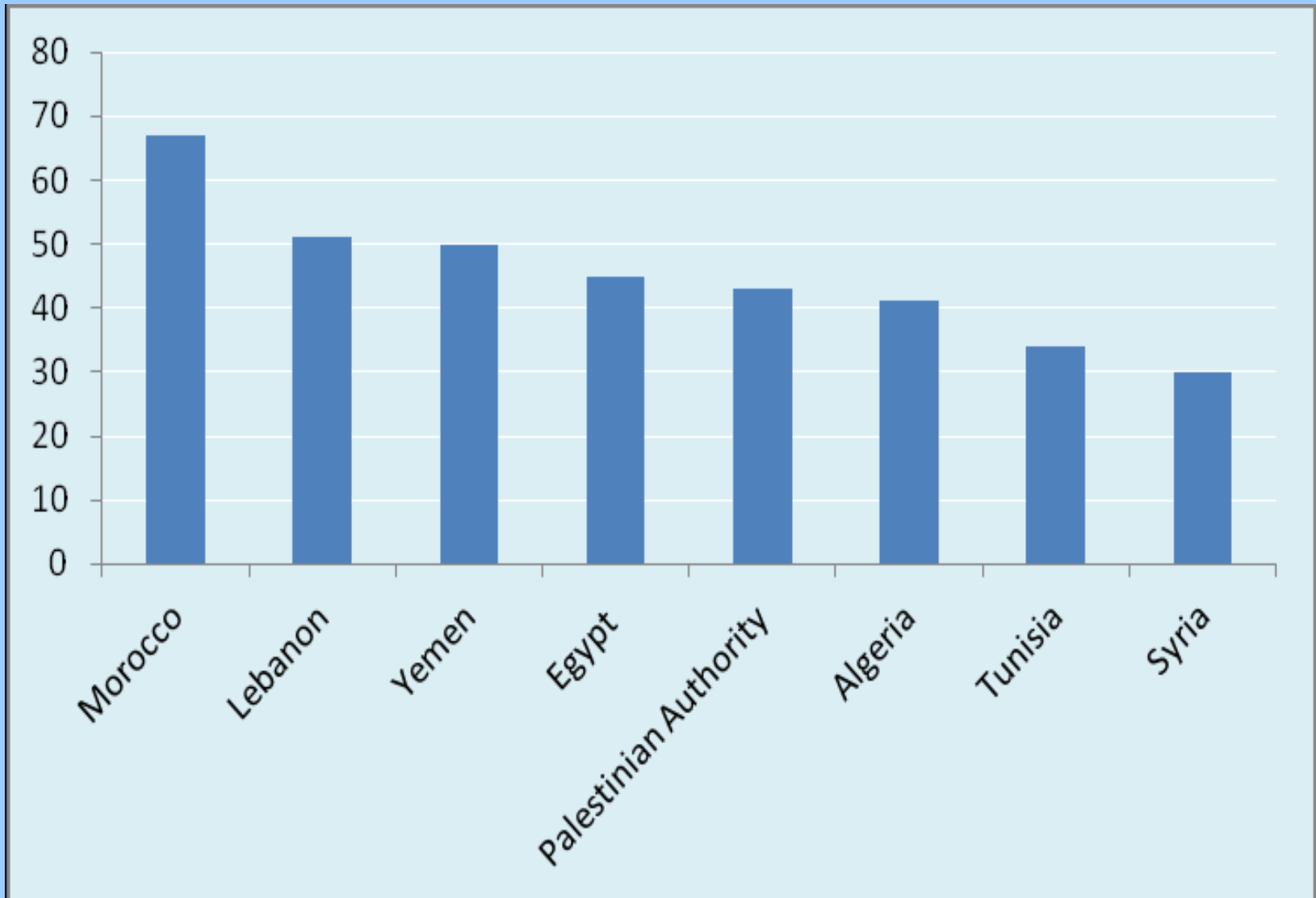
Informality

Region	Informality
MENA	67.00%
<i>GCC</i>	64.00%
<i>non-GCC</i>	67.20%
Developed Countries	8.90%
Europe and Central Asia (ECA)	39.40%
Latin American and Caribbean (LAC)	61.30%
East Asia and Pacific (EAP)	76.10%
South Asia (SA)	91.00%
Sub-Saharan Africa (SSA)	94.70%

Informality = % of Labor Force not contributing to Social Security

Loayza, N., and Wada, T. 2009. Informal Labor in the Middle East and North Africa: Basic Measures and Determinants. Mimeo. World Bank, Washington D.C.

Informal Employment in some MENA Countries



Source: ILO 2011

6. Institutions, Economic Development and Politics

Institutions and Economic Development

By **institutions** we mean rules of structural social interaction (both formal and informal) – they structure incentives in human exchange (be it economic, political or social).

Formal institutions – property rights, legal system, rule of law, constitution.

Informal institutions – how to behave in everyday life (linked to religion, history, social acceptability).

Institutions are the Fundamental Causes of Growth

Institutions and Economic Development

Political Institutions: encourage participation and democracy, rule of law.

Economic Institutions: encouraging investment through incentives, human capital, entrepreneurship, innovation, occupational choice, land ownership, property rights.

Market Institutions: permit the efficient allocation of resources, e.g., financial markets; insurance.

Culture: values, beliefs, religions

Geography: climate (affects productivity and worker effort), agricultural (technological) productivity higher in temperate zones than in tropics, burden of infectious diseases, natural endowments, transport costs

Trade and Integration: affects productivity changes.

Human capital: capability of being active and produce wealth

Institutions and Economic Development

Types of Institutions

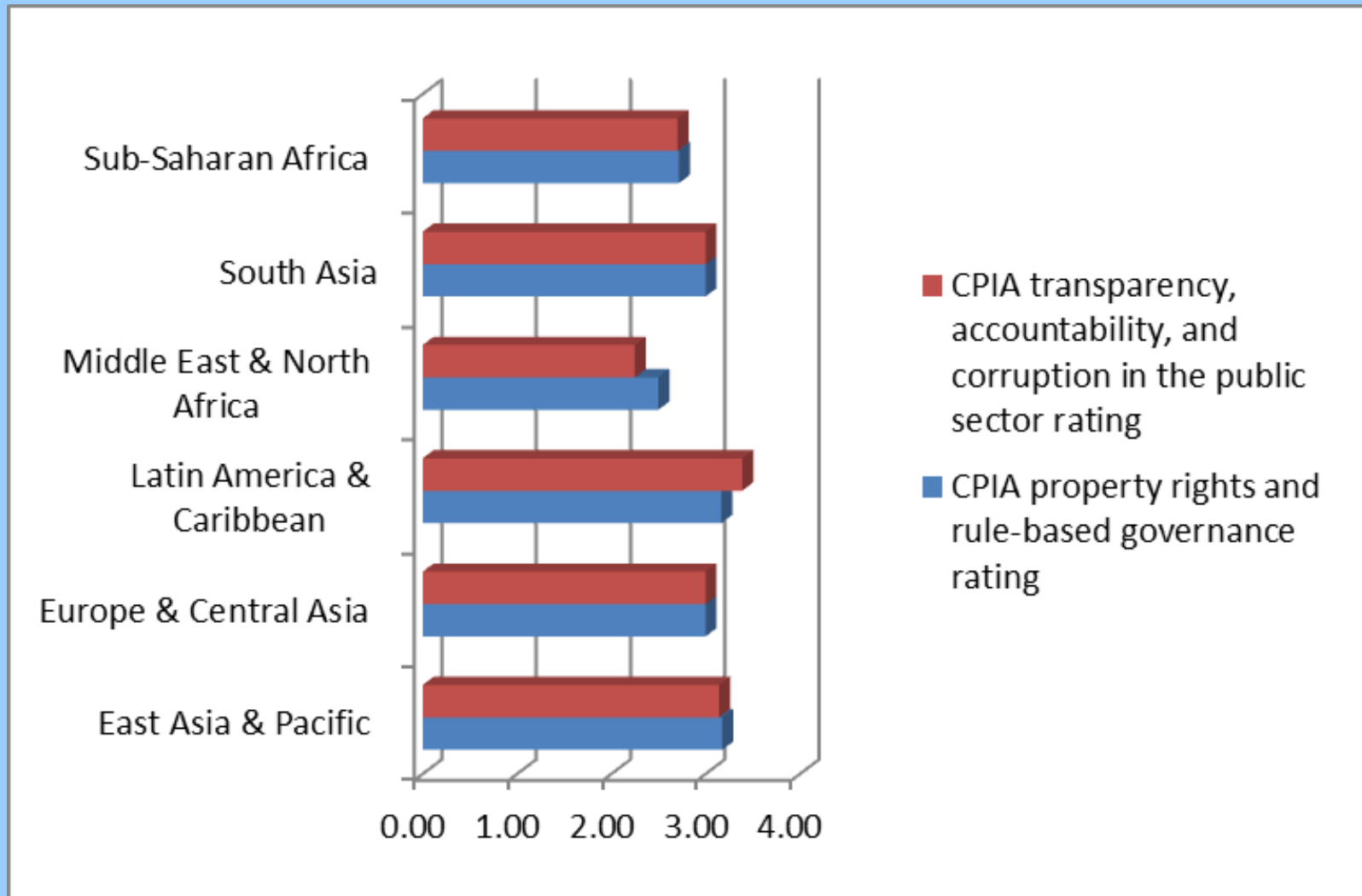
- (i) Institutions that protect individual property rights, e.g., defence against expropriation of resources.
- (ii) Institutions related to democratic political rights (Sen A. pp. 178-84)
- (iii) Institutions correcting co-ordination failure – efficiency of government for example in implementing policy.

Countries can have good and bad institutions, e.g., South Korea used to have one party political system.

Measurement of Institutions

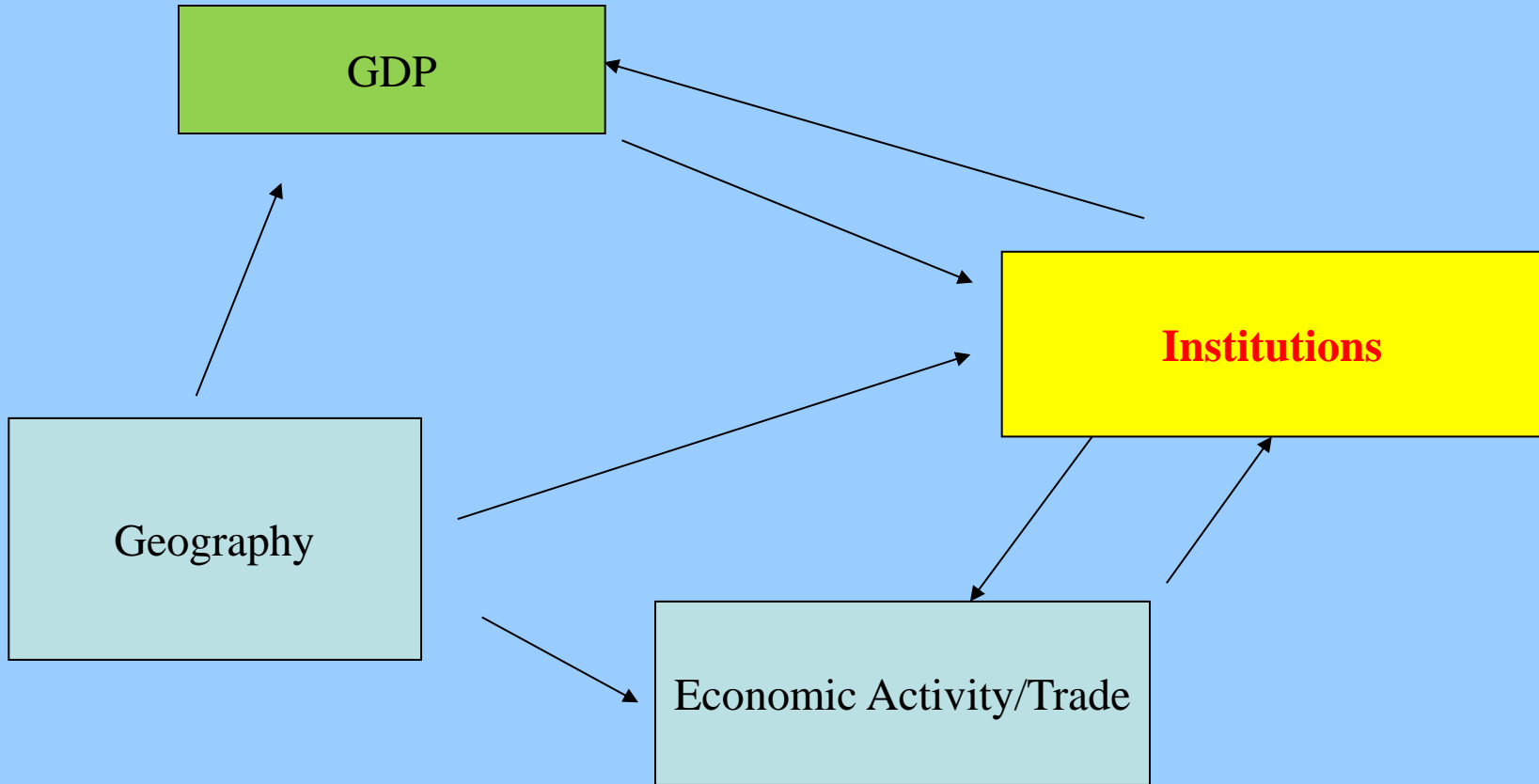
- The measure of the effectiveness and working of different institutions is a **challenging** undertaking.
- Institutions are normally measured using surveys of sample of people who evaluate the institutions they are dealing with.
- Other form of measurement of institutions is indirect., i.e., the decline of the level of mortality over time is an indicator that the institutional setting in that particular country is improving.

Institutional Indicators



Data World Bank 2012

Institutions and Economic Development



Institutions and Economic Development

A. Institutional View of Development

Institutions role in Economic Growth and Development – Endogeneity (Acemoglu et al. 2001)

How do Institutions form?

Institutions can and will likely result in **élites** who will shape institutions and then also attempt to retain their position of power. There may be successful or not be, but they can be replaced by alternative **élites**.

Acemoglu makes an important distinction between institutions that can be (i) developmental or (ii) predatory

(i) **Developmental Institutions** – encourage investment, growth and productivity.

(ii) **Predatory** – extractive institutions that favour the few.

Institutions and Economic Development

Evidence of Institutions and Economic Growth

Korea – natural experiment since split into North and South Korea in 1948. Same geography, history and culture. North Korea went Dictator and Socialism, South Korea went Dictator and Capitalist that involved private property rights and in 1980 moved to a democracy.

Micro level evidence of importance land property rights have on investment in agriculture in LDCs.

Macro level evidence looking at within country and between country – problem with this is though that **we cannot control for whether “better” institutions cause growth or growth leads to “better” institutions (*endogeneity*)**

Institutions and Economic Development

The issue of *endogeneity* must be solved in most empirical work in economics.

In a statistical model, a parameter or variable is said to be endogenous when there is a correlation between the parameter or variable and the error term. Endogeneity can arise as a result of *measurement error, autoregression with autocorrelated errors, simultaneity and omitted variables*. Broadly, **a loop of causality** between the independent and dependent variables of a model leads to endogeneity.

The solution is to find a variable or a factor that meaningfully can cause **institutions** but does **not** directly affect economic growth.

Acemoglu, Johnson and Robinson (American Economic Review, 2001) addressed this point.....

Endogeneity

- Endogeneity can come from an omitted uncontrolled confounding variable.

A variable is both correlated with an independent variable in the model and with the error term. Equivalently, the omitted variable both affects the independent variable and separately affects the dependent variable.

- Assume that the "true" model to be estimated is,

$$Y = \alpha + \beta x_i + \gamma Z_i + u_i$$

but we omit Z_i (perhaps because we don't have a measure for it) when we run our regression.

Z_i will get absorbed by the error term and we will actually estimate,

$$Y = \alpha + \beta x_i + \varepsilon_i \quad (\text{where } \varepsilon_i = \gamma Z_i + u_i)$$

i)

If the correlation of x and Z_i is not 0 and Z separately affects Y (meaning $\gamma \neq 0$), then x is correlated with the error term ε_i (one of the assumptions of the regression).

- Here, x and Z are not exogenous for alpha (α) and beta (β) since, given x , the distribution of Y depends not only on alpha (α) and beta (β), but also on Z and gamma (γ).

Institutions and Economic Development

Primacy of Institutions

Acemoglu et al. control for settler mortality as an instrument to control for endogeneity in their growth model. The variables in the model are

M = settler mortality

S = Colonial Settlements

R = Early Institutions and Modern Institutions

Y = Economic Performance

Settlements lead to the export of colonial institutions such as property rights. Where settlements failed or were not attempted (due to high settler mortality) only extractive institutions were exported.

Institutional Proxy is captured by either *index of protection against expropriation* or by *constraints on the executive*.

Institutions and Economic Development

The Model – 2SLS:

$$\text{Log}Y_i = \alpha + \beta R_i + \gamma X_i + u_i$$

$Y = \text{GDP per capita in 1995 in } \$ (\text{PPP a day}).$

$64 \text{ countries in the sample}$

$R = \text{Institutional Proxy}$

$X = \text{Other controls}$

$$R_i = a + b \log M_i + cX_i + v_i$$

$M = \text{Settler mortality 17th – 19th ce}$

Institutions and Economic Development

TABLE 4—IV REGRESSIONS OF LOG GDP PER CAPITA

	Base sample (1)	Base sample (2)	Base sample without Neo-Europes (3)	Base sample without Neo-Europes (4)	Base sample without Africa (5)	Base sample without Africa (6)	Base sample with continent dummies (7)	Base sample with continent dummies (8)	Base sample, dependent variable is log output per worker (9)
Panel A: Two-Stage Least Squares									
Average protection against expropriation risk 1985–1995	0.94 (0.16)	1.00 (0.22)	1.28 (0.36)	1.21 (0.35)	0.58 (0.10)	0.58 (0.12)	0.98 (0.30)	1.10 (0.46)	0.98 (0.17)
Latitude		-0.65 (1.34)		0.94 (1.46)		0.04 (0.84)		-1.20 (1.8)	
Asia dummy							-0.92 (0.40)	-1.10 (0.52)	
Africa dummy							-0.46 (0.36)	-0.44 (0.42)	
“Other” continent dummy							-0.94 (0.85)	-0.99 (1.0)	
Panel B: First Stage for Average Protection Against Expropriation Risk in 1985–1995									
Log European settler mortality	-0.61 (0.13)	-0.51 (0.14)	-0.39 (0.13)	-0.39 (0.14)	-1.20 (0.22)	-1.10 (0.24)	-0.43 (0.17)	-0.34 (0.18)	-0.63 (0.13)
Latitude		2.00 (1.34)		-0.11 (1.50)		0.99 (1.43)		2.00 (1.40)	
Asia dummy							0.33 (0.49)	0.47 (0.50)	
Africa dummy							-0.27 (0.41)	-0.26 (0.41)	
“Other” continent dummy							1.24 (0.84)	1.1 (0.84)	
R ²	0.27	0.30	0.13	0.13	0.47	0.47	0.30	0.33	0.28
Panel C: Ordinary Least Squares									
Average protection against expropriation risk 1985–1995	0.52 (0.06)	0.47 (0.06)	0.49 (0.08)	0.47 (0.07)	0.48 (0.07)	0.47 (0.07)	0.42 (0.06)	0.40 (0.06)	0.46 (0.06)
Number of observations	64	64	60	60	37	37	64	64	61

Notes: The dependent variable in columns (1)–(8) is log GDP per capita in 1995, PPP basis. The dependent variable in column (9) is log output per worker, from Hall and Jones (1999). “Average protection against expropriation risk 1985–1995” is measured on a scale from 0 to 10, where a higher score means more protection against risk of expropriation of investment by the government, from Political Risk Services. Panel A reports the two-stage least-squares estimates, instrumenting for protection against expropriation risk using log settler mortality; Panel B reports the corresponding first stage. Panel C reports the coefficient from an OLS regression of the dependent variable against average protection against expropriation risk. Standard errors are in parentheses. In regressions with continent dummies, the dummy for America is omitted. See Appendix Table A.1 for more detailed variable descriptions and sources.

Institutions and Economic Development

The 'b' coefficient (mortality variable) in the first stage of the regression is negative and significant – higher mortality rate the worse institutions are.

The beta coefficient is positive and significant implying institutions have a positive impact on current GDP level.

The introduction of latitude in line with Rodrik's work does not change the main result.

If the US, Canada, Australia and New Zealand are omitted then the results are still robust.

Institutions and Economic Development

Main Issues with Acemoglu et al. (2001)

- I. Colonial Experience – Settler Mortality is an interesting and clever instrument for identifying the Institutional variable. *However, what about differences in growth between Finland, China, Luxembourg who had no colonial history?*
- II. Pre-colonial histories are important. Brazil and India have different histories prior to colonization. Extractive institutions such as the land revenue system attributed to Britain in India were present during the Moghul period.
- III. It fails to consider political institutions.
- IV. Is colonial death rate really capturing the under lying cause of institutions? Decisions to settle maybe caused by whether there is a need to settle in the first place. Other factors influence the decision to settle.
- V. There is also the view that the proxy for institutions (risk of expropriation by the government) is not really picking up any permanent set of rules of a country. Rather this in itself is an outcome of what has gone before.

Institutions and Economic Development

B. The Developmental View

That institutions form and emerge from within countries over time and that economic, political and social development cause institutions to change.

Opposite of Acemoglu et al.

Development and Institutions are **caused by human capital** – Lipset (1960) argued that through greater education people would be likely and more able to resolve differences by negotiation and reach rational solutions to disputes (i.e., so-called Coase-type end game).

Externality of higher initial education of a population is greater political and social stability as well as economic spill overs in terms of productivity and technology.

This view is shown on Glaeser et al. paper Journal of Economic Growth (2004).

Institutions and Economic Development

Glaeser et al. argue that measures of institutional quality such as *risk of expropriation* (used in Acemoglu et al. 2001), *government effectiveness* and *constraints on the executive* are “**outcomes**” and do not represent “**deep**” institutions.

Constraints on the executive is measured as a score between ‘1’ (bad institutions) and ‘7’ (good institutions). If this was a measure of a ‘set of rules’ as North argues institutions are defined as, then why do they change so much?

Because they are **outcomes** from other factors – Haiti gets score of ‘1’ under dictatorship during 1960-89, then a score of ‘6’ when Aristide is elected in 1990, drops to ‘1’ again when he’s ousted between 1991-93 and rises again to 6 when Aristide returns to power and falls to 3 during 2000-01. How can institutions change so quickly? Glaeser argues they cannot.

Institutions and Economic Development

Glaeser et al estimate the following equation...

Growth of GDP per capita (1960-2000) = $\alpha + \gamma_1 \log$ GDP per capita (1960) + γ_2 Log years of schooling (1960) + γ_3 (share of population living in temperate zone (1995) + β Institutional proxies

Results are as follows (2004, pp.35).....

Institutions and Economic Development

Table 4
Economic growth, political institutions and human capital

The table shows OLS regressions for the cross-section of countries. The dependent variable in all specifications is the growth of GDP per capita for the period 1960-2000. The specifications include a constant but we do not report the estimates in the table. Robust standard errors are shown in parentheses. All variables are defined in Appendix 1.

	<i>Dependent variable is growth of GDP per capita 1960-2000</i>							
Log GDP per capita (1960)	-0.0114 ^a (0.0033)	-0.0136 ^a (0.0033)	-0.0112 ^a (0.0033)	-0.0122 ^a (0.0033)	-0.0141 ^a (0.0037)	-0.0130 ^a (0.0037)	-0.0090 ^a (0.0034)	-0.0105 ^a (0.0036)
Log years of schooling (1960)	0.0060 ^b (0.0025)	0.0076 ^a (0.0024)	0.0063 ^b (0.0024)	0.0060 ^b (0.0023)	0.0077 ^b (0.0032)	0.0073 ^b (0.0031)	0.0073 ^a (0.0025)	0.0080 ^a (0.0026)
Share of population living in temperate zone (1995)	0.0175 ^a (0.0049)	0.0132 ^a (0.0041)	0.0179 ^a (0.0046)	0.0104 ^c (0.0055)	0.0242 ^a (0.0049)	0.0231 ^a (0.0047)	0.0175 ^a (0.0050)	0.0184 ^a (0.0052)
Executive constraints (1960-2000)	0.0021 ^b (0.0008)							
Expropriation risk (1982-1997)		0.0040 ^a (0.0014)						
Autocracy -- Alvarez (1960-1990)			-0.0060 ^a (0.0032)					
Government effectiveness (1998-2000)				0.0075 ^a (0.0024)				
Judicial independence (1995)					-0.0041 (0.0057)			
Constitutional review (1995)						0.0047 (0.0064)		
Plurality (1975-2000)							0.0010 (0.0027)	
Proportional representation (1975-2000)								0.0019 (0.0031)
Observations	71	69	71	71	54	54	71	70
R ²	0.44	0.56	0.44	0.48	0.45	0.45	0.41	0.44

a=significant at 1 percent; b=significant at 5 percent; c=significant at 10 percent.

Institutions and Economic Development

Interpretation

Coefficient on Initial level of schooling is always **+ve** and significant.

So to the coefficients on Initial GDP per capita (-ve and significant) and Share of Population living in Temperate Zone (+ve and significant).

The beta coefficients are only significant when the institutional proxies stand for **outcomes** (expropriation risk (82-90) or government effectiveness (98-2000)).

Other proxies for institutions such as judicial independence or constitutional review are insignificant.

Institutions and Economic Development

What can we say about Institutions and Development?

Measuring institutions is difficult. Popular measures are subject to criticism since they are (i) 'outcomes' rather than anything 'deep' (ii) they are also largely subjective (iii) when non-outcome proxies for institutions are used they are insignificant.

Looking at country specific evidence though both the Institutional View and the Developmental View have strengths but are not universal.

Institutional Primacy View – Countries have similar backgrounds and histories but operate under different institutions and hence diverge onto different growth paths, e.g., North and South Korea, East and West Germany, Burma and Thailand.

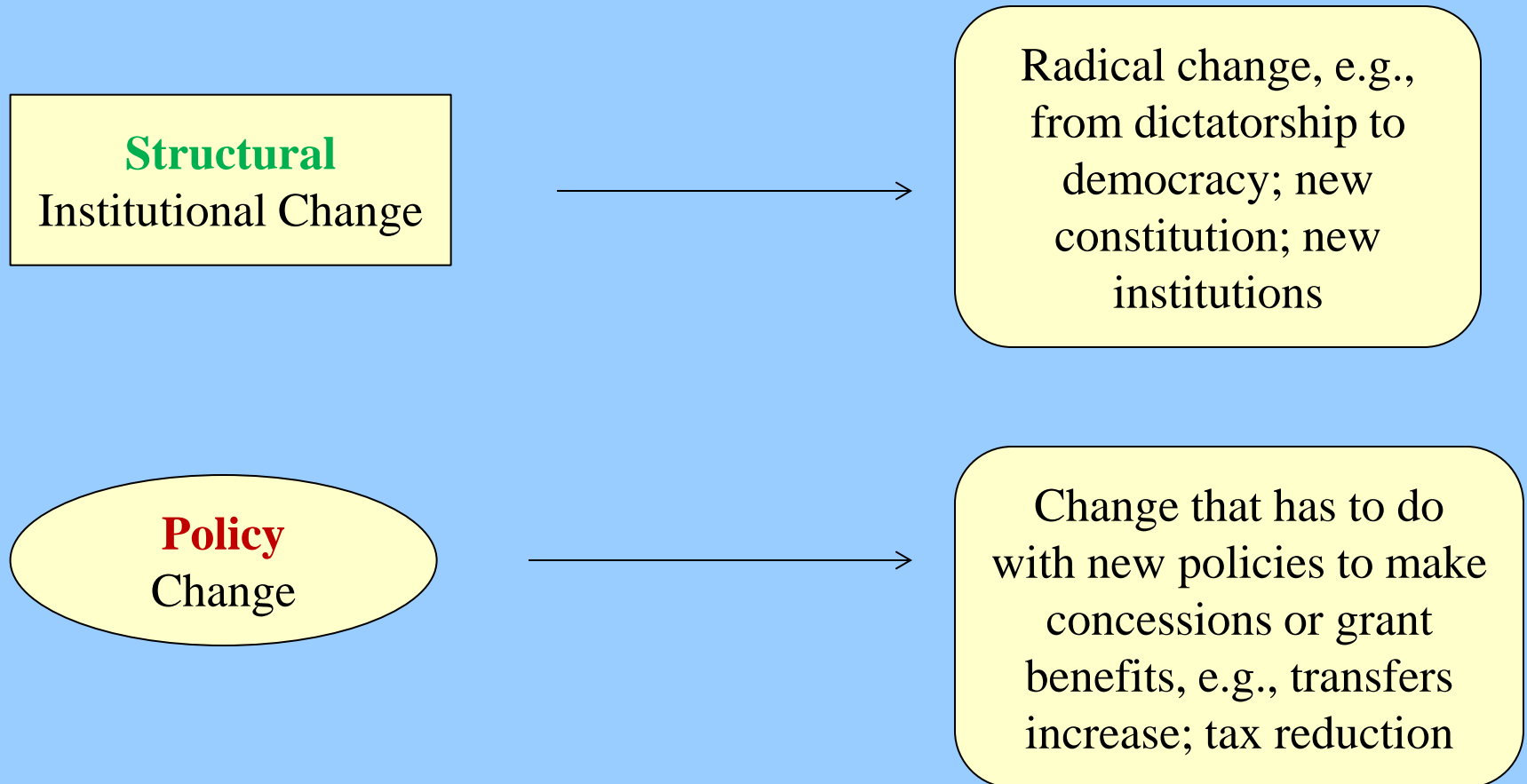
Development View - Some countries have very different initial institutions and different histories, but have the same level of economic development and have very similar current institutions, e.g., Tiger Economies - Taiwan and South Korea with Japanese colonialisation then US occupation compared to Hong-Kong and Singapore with British colonial past and less intervention.

Political Economy – Politics - and Institutional Development

Developments in the political arena are powerful agenda setters and drive change:

- Elites
- Interest groups – national and international- that press (or fail to press) demands on government
- Civil Society
- National mood
- New administrations
- New partisan/ideological distributions in Congress
- Personal Interest

Structural Change and Policy Change



A Model for Institutional Structural Change

Key Parameters

Inequality: benefits of democratization for citizens and costs of democratization for the elite

Civil society: degree of empowerment of citizens

Cost of repression: how costly the repression alternative will be.

Institutional Change

Elites control non-democracy, but citizens can sporadically solve their collective action problem; exercise de facto power; and threaten a revolution or social unrest.

Elites can respond with:

1. repression;
2. concessions with unchanged political institutions;
3. change in political institutions, e.g., democracy.

Institutional Change

Concessions generally “cheapest” option, but may not be credible because: de facto power of citizens often transitory, e.g., citizens can solve their collective action problem with probability q .

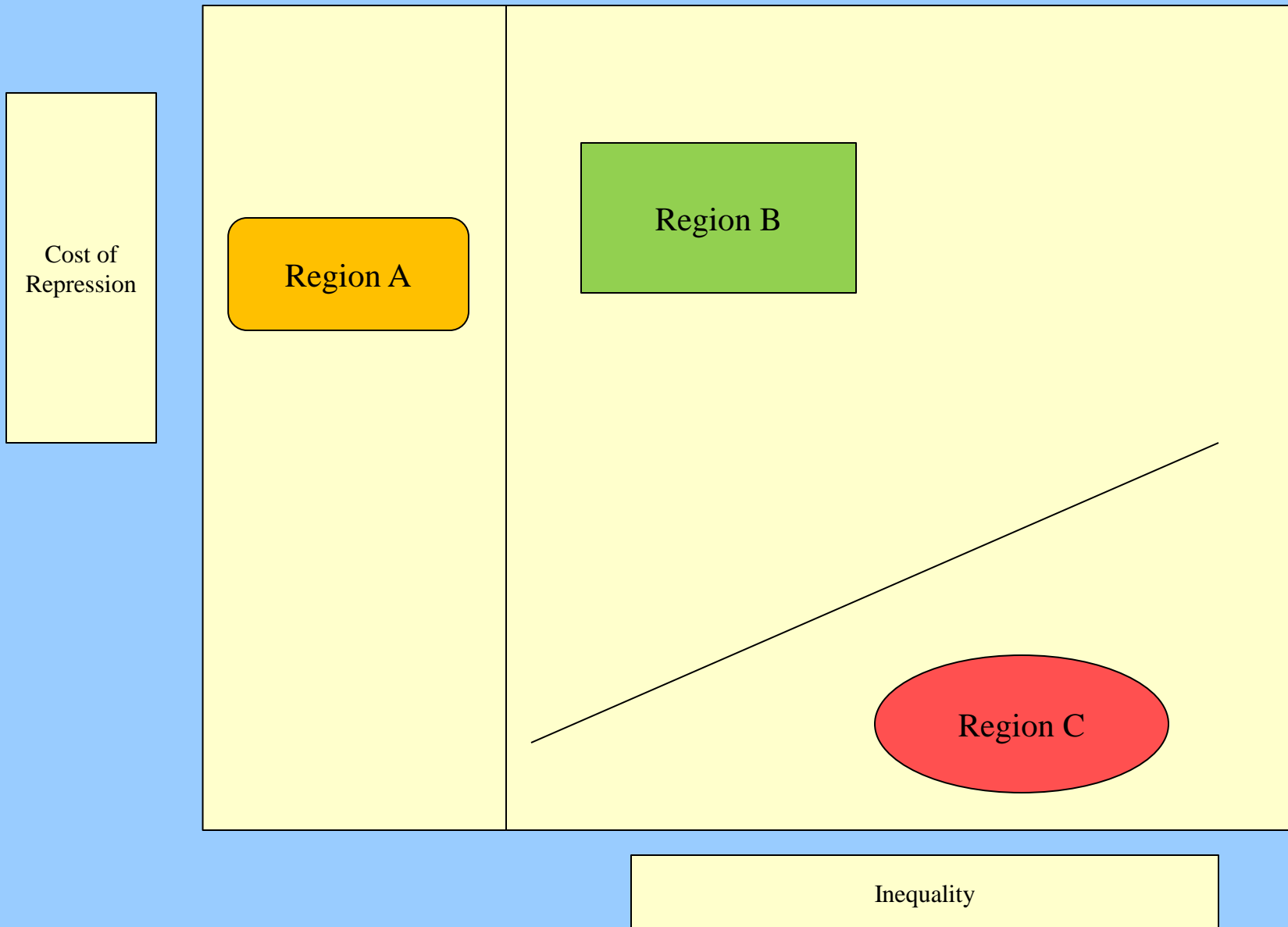
If q close 1, then de facto power of citizens is almost permanent and can balance the power of the elite. Then concessions become credible.

If q is small, then concessions are not credible (in sub game perfect equilibrium).

Democracy – radical institutional change- arises when repression is too costly and concessions are non-credible.

Democracy gives a commitment to future pro-citizen policies! turning temporary de facto power into more durable de jure power.

Democracy in the Middle East



The EU and the Middle East

- In 1973, the then European Community (EC) recognized the rights of the Palestinians; in 1980, through its Venice Declaration, the EC also recognized the Palestinian right to self-determination. In 1999, the EU's Berlin Declaration "prepared the ground" for the adoption of the two-state solution; and in 2002, through its Seville Declaration, the EU made explicit that a future Palestinian state should be based on the 1967 borders.
- In 2007, Nicolas Sarkozy launched a proposal to establish a "**Mediterranean Union**", which would consist principally of Mediterranean states. The Mediterranean Union would be modeled on the European Union with a shared judicial area and common institutions. At the Paris Summit for the Mediterranean (13 July 2008), 43 Heads of State and Government from the Euro-Mediterranean region decided to launch the Barcelona Process: Union for the Mediterranean (UfM).

The EU and the Middle East

- The Mediterranean Union accepts and commits to the purpose of promoting "**peace, stability and prosperity**" throughout the region. The four chapters of cooperation developed in the framework of the Barcelona Process remain valid:
 - *Politics and Security*
 - *Economics and Trade*
 - *Socio-cultural*
 - *Justice and Interior Affairs.*
- The objective to establish a **Free Trade Area** in the Euro-Mediterranean region by 2010 (and beyond). In addition to these four chapters of cooperation, the 43 Ministers of Foreign Affairs gathered in Marseilles on November 2008 identified six concrete projects that target specific needs of the Euro-Mediterranean region and that will enhance the visibility of the Partnership:
 - *De-pollution of the Mediterranean; Maritime and land highways; Civil protection; Alternative energies: Mediterranean solar plan; Higher education and research: Euro-Mediterranean University.*
 - *The Mediterranean business development initiative.* The purpose of the initiative is to promote small and medium-sized enterprises from the Mediterranean partner countries by "assessing the needs of these enterprises, defining policy solutions and providing these entities with resources in the form of technical assistance and financial instruments."

The EU and the Middle East

- At the beginning of November 2010 the peace talks stalled, and the Egyptian co-presidents conditioned the occurrence of the summit on a gesture from Israel that would allow the negotiations to resume. According to some experts the announcement of the construction of 1,300 **new settlements** in East Jerusalem ended all the possibilities of celebrating the Euro- Mediterranean summit of heads of States. On the 15th of November it was decided to postpone the summit *sine die*, alleging that the stagnation of the Middle East Peace Process would hinder a "satisfactory participation."
- In December 2010, the *Arab Spring* began.
- In May 2012 **Nicholas Sarkozy lost** the election for President of France.
- On May 14th, 2012, EU foreign ministers stated for the first time clearly that “ending the conflict was a European interest”. This culminated in the decision of the majority of EU member states’ governments in late November 2012 to abstain or vote in favor of the upgrade of Palestine to “***observer-member state***” in the UN.
- Starting in January 2014, EU financial assistance will no longer go to Israeli entities in the occupied territories. The directive covers most areas of co-operation between the EU and Israel such as science, economics, culture, sports and academia, but it does not cover trade-related issues.

The EU-Middle East- Economic and Financial Cooperation

- The **European Commission (EC)** contributes to the relationship with Mediterranean countries through the European Neighborhood Policy Instrument (ENPI). Some of the initiatives: De-pollution of the Mediterranean (€22 million); Maritime and land highways (€7.5 million); Alternative energies: Mediterranean Solar Plan (€5 million); Euro-Mediterranean University of Slovenia (€1 million)
- The **European Neighborhood Instrument (ENI)** came into force in 2014. It is the financial arm of the European Neighborhood Policy, the EU's foreign policy towards its neighbors to the East and to the South. It has a budget of €15.4 billion and will provide the bulk of funding through a number of programs.
- The **European Investment Bank (EIB)** contributes to the support of Mediterranean countries through its Euro-Mediterranean Investment and Partnership (FEMIP). Following the June 2012 meeting the EIB announced it would give € 500 million to support projects in the Mediterranean.
- The InfraMed Infrastructure Fund was established in June 2010 by five European financial entities: the French Caisse des Dépôts, the Moroccan Caisse de Dépôts et de Gestion, the Egyptian EFG Hermes, the Italian Cassa Depositi e Prestiti and the **European Investment Bank (EIB)**. On an initial phase, the Fund will contribute €385 million to projects on infrastructure.

The EU-Middle East- Economic and Financial Cooperation

- Traditionally, the European Union (EU) has been blamed for its ‘*megaphone*’ diplomacy and for its rhetoric that is never translated into real foreign policy. UE’s voice regarded as “*unpleasant background noise*”, the phrase used by Foreign Affairs Ministry spokesman Yigal Palmor in 2012.
- North European countries do not regard the Middle East as a priority as compared to European eastward expansion and consolidation.
- The financial and economic crisis of 2008 hit particularly hard European Mediterranean countries, i.e., Greece, Italy, Spain and weakened the European interest on the Middle East and Mediterranean countries.

The United States and the Middle East

- The United States, as the heir to British imperialism in the region, has been a frequent object of misgiving. Since the end of World War II, the United States, like the European colonial powers before it, has been entangled in the region's political conflicts. The main factors of the US policy in the Middle East are:
 - desire to keep the vast **oil reserves** in hands friendly to the United States,
 - wish to keep out potential rivals (such as the Soviet Union at the time of the **Cold War** and possibly China),
 - opposition to neutrality in the cold war,
 - fight to terrorism, and
 - domestic political considerations.
- In this contest, the United States provides a **continuous staunch support to Israel**. At the same time, the United States has been associated with the support of **authoritarian regimes** in Middle East countries, e.g., Mubarak in Egypt, Hafez al-Assad in Syria. The US policy in the Middle East before September 11, 2001 includes U.S. alliances with Iraq to counter Iran; and then with Iran and Syria to counter Iraq; the Gulf War of 1991.
- The feeling of anger and humiliation after the **terrorist attacks of the September 11th**, 2001, has been as the main factor that compelled the United States to invade Afghanistan (2001) and Iraq (2003) under the so-called Bush Doctrine (2002).

The United States and the Middle East

- Beginning in the early 1970s, the United States dramatically increased its foreign assistance to the Middle East. After the U.S. withdrawal from South Vietnam, the Middle East as a whole began to receive more U.S. foreign aid than any other region of the world, a trend that has continued to this day. Countries in the Middle East receive a disproportionate share of U.S. aid.
 - The leading recipient of aid is Israel, but several other countries in the region, - Egypt, Lebanon, Palestinians and Gaza, and Jordan - are awarded hundreds of millions of US dollars annually.
 - The Near East region as a whole, which includes North Africa and the Persian Gulf States and Iraq, received \$5.26 billion in 2010, more than all of Africa (\$5.19 billion), and nearly eight times the amount of aid delivered to East Asia.

The United States and the Middle East

- People in Arab countries in the Middle East perceived the new order of the Bush Doctrine as dangerous as the old order because it would feature an activist U.S. foreign policy without the inhibitions imposed by the superpower rivalry.
- Currently, faced with the Arab Spring, to the eyes of many observers and people in Middle East countries, the **US policy looks ineffective**. The United States has not provided a clear support to the democratic process that the Arab Spring has initiated (Libya, Egypt, and Syria) and it is struggling between the old authoritarian and gradualist approach and a rhetoric support to the democratic process.
- American policies in the Middle East, mainly stem from the belief that American military involvement in the Middle East protects U.S. access to “*cheap*” oil. That portends ill for the people of the Middle East, as well as for American citizens, who will see their taxes continue to raise, their consumer economy increasingly distorted by military spending, and their blood spilled—all in the name of U.S. leadership. In other words, the notion that U.S. policy in the Middle East helps give Americans access implies military and other costs—including two Gulf Wars—that should be added to the price that U.S. consumers pay.

Political Prospects in Middle East Countries

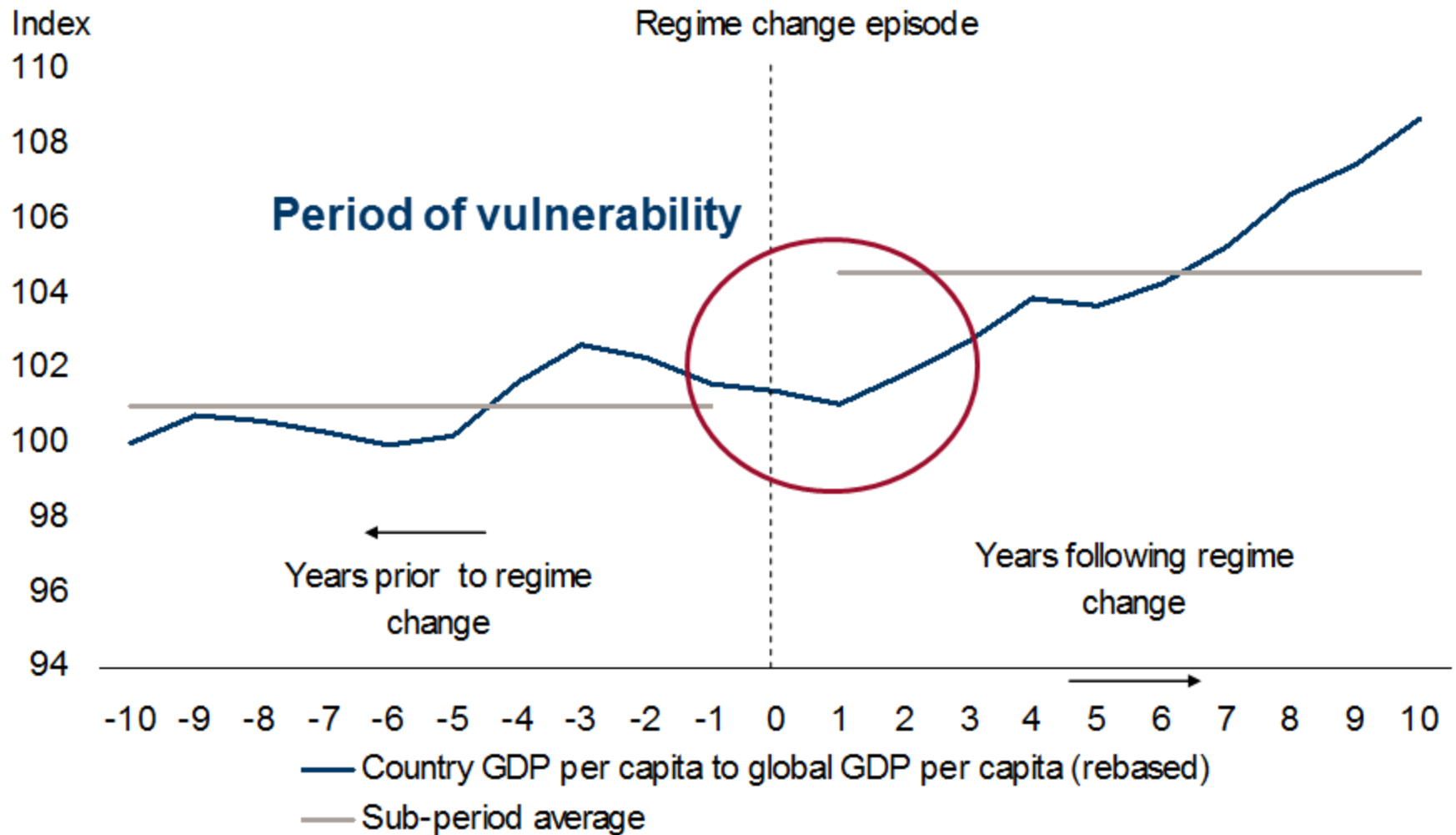
The so – called *Arab Spring* has made the political environment in the Middle East and North Africa not conducive to political and institutional stability and democracy.

After 70 years of broken Western promises regarding Arab independence, it should not be surprising that the populations (as opposed to some of the political regimes) of the Middle East view the West - and particularly the United States- with **suspicion and hostility and also ineffectiveness**.

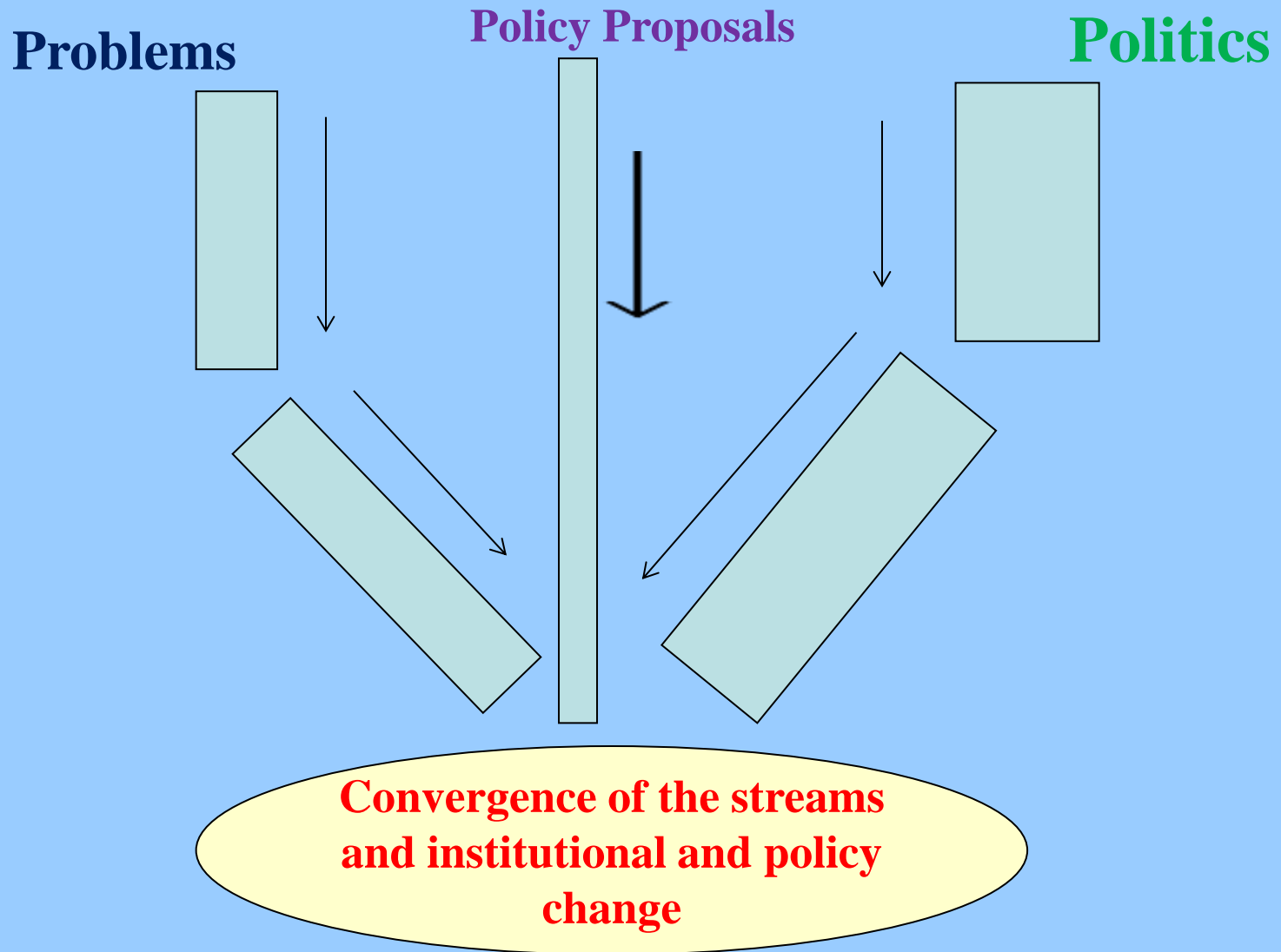
The threat of radical Islamism and the energy interest of Western countries in the area may continue to make it tempting for the USA and the EU to support non-Islamist authoritarian forces for some time to come.

Such factors by themselves do not favor democratic development, and they do suggest that democratization in the Middle East and North Africa will hinge almost entirely on each country's domestic balance of power between pro- and anti-democratic forces; modernity and tradition.

GDP per capita increases post-regime change



The Kingdon Model of Policy Change: the Streams



Policy Change: Political Decisions

Agreement is reached by bargaining

- Trading provisions for support “*pork barrel*”
- Adding elected officials to coalitions by giving concessions
- Compromising from ideal positions to those that will gain wider acceptance
- **Corruption**
- **National mood and elected officials more important than interest groups for political decisions**
- **Coalition Governments expand the role of the public sector in the economy**

7. Strategies and Policies

Strategies and Policies

Strategies and policies should be not only comprehensive but also adapted to the particular needs, circumstances, and potential of each country.

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