



The Broader Middle East Initiative: Requirements for Success in the Gulf

Strategic Insights, Volume III, Issue 8 (August 2004)

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Strategic Insights is a monthly electronic journal produced by the Center for Contemporary Conflict at the Naval Postgraduate School in Monterey, California. The views expressed here are those of the author(s) and do not necessarily represent the views of NPS, the Department of Defense, or the U.S. Government.

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There is a belief that (Helsinki) contributed to bringing Europe together and played a significant role in tearing down the Soviet Union... In the same way, this idea [The Broader Middle East Initiative] would tear down the attractiveness of (Islamic) extremism.[1]

The Initiative should not be rejected just because it was proposed by the U.S. [2]

The truth is that most in the region desire change and want to improve their current situation: they support change, and some have no objection to it being imposed [from without] if it is impossible to [achieve it] from within by peaceful means and mutual persuasion.[3]

Introduction

One of the more significant developments following the 9/11 attacks is the growing realization in the United States and elsewhere that domestic conditions throughout the Middle East are a major cause of radicalization. More specifically this view sees radicalization and the growing terrorist threat in the region as stemming from a failed modernization process that has created weak states.[4] In turn, these states have failed to provide for the needs of their populations, either economically through improved standards of living and opportunity or politically through increased voice and participation.

In this regard, the adoption of the United States sponsored Broader Middle East and North African Initiative -BMEI (a later version of the Greater Middle East and North African Initiative—GMEI) [5] by the Group of Eight Industrialized Nations (G-8) at their June 8-10 summit in Sea Island, Georgia, is seen by the Bush Administration as representing a milestone in the war on terrorism. The initiative has two key elements. The first is the launching of a "Partnership for Progress and a Common Future with the Region of the Broader Middle East and North Africa." The second is a plan for the G-8 countries to support reform in Arab countries.

The purpose of this *Strategic Insights* article is to examine several of the operational issues raised by the Initiative. What are realistic goals for success? The key areas of reform needed to achieve these goals? The difficulties in implementation? In addressing these issues, several lessons from the transition economies of Eastern Europe and the former Soviet Union are found to be highly relevant.

Background

The initiative was inspired by the 1975 Helsinki accords, signed by 35 nations (United States, the former Soviet Union, and most European states). That pact was designed to recognize disputed post-World War II borders and establish a mechanism for settling other disagreements. Human rights and fundamental freedoms became key parts of the treaty, and the West promoted and protected dissident groups in the Soviet bloc and urged greater freedoms for its residents.

In a similar fashion, the Partnership consists of a statement of principles about "human dignity, freedom, democracy, rule of law, economic opportunity, and social justice" and the establishment of Forum for the Future, a framework for regular ministerial level meetings on political and economic reform in the Broader Middle East and for parallel meetings of civil society and business leaders.

In short, the plan is based on the assertion that stopping the growth in "the region's pool of politically and economically disenfranchised individuals," will slow the trend towards rising "extremism, terrorism, international crime and illegal migration" in the region. The Initiative addresses topics such as open markets, free elections, press liberty, and support for human rights organizations. In terms of scope, the Initiative covers the twenty-two nations of the Arab League, Turkey, Israel, Pakistan and Afghanistan.

According to the official statement released by the G-8, the Partnership will focus on three areas:

- Political. In the political sphere, progress toward democracy and the rule of law entails instituting effective guarantees in the areas of human rights and fundamental freedoms, which notably imply respect for diversity and pluralism. This will result in cooperation, the free exchange of ideas, and the peaceful resolution of differences. State reform, good governance, and modernization are also necessary ingredients for building democracy.
- Social/Cultural. In the social and cultural sphere, education for all, freedom of expression, equality between men and women, as well as access to global information technology are crucial to modernization and prosperity. A better-educated workforce is a key to achieve participation in the globalized world. We will focus our efforts to reduce illiteracy and increase access to education, especially for girls and women.
- Economic. In the economic sphere, creating jobs is the number one priority of many countries in the region. To expand opportunity, and promote conditions in which the private sector can create jobs, we will work with governments and business leaders to promote entrepreneurship, expand trade and investment, increase access to capital, support financial reforms, security property rights, promote transparency and fight corruption. Promotion of intra-regional trade will be a priority for economic development of the of the Broader Middle East and North Africa.

The plan to support reform is focused on the need to deepen democracy and broaden public participation, build a knowledge society, and promote economic development. In part these objectives are to be met through a series of initiatives. These include a microfinance initiative to help small entrepreneurs, a project to enhance literacy, and support for training programs for business and entrepreneurship.

In the aftermath of the G-8 meetings, it was not clear how these activities would be financed. The United States has not announced any new funding and projects will have to draw on the budget of the Middle East Partnership Initiative (MEPI) and other existing aid projects. The vagueness of the statements adopted, the generalities concerning the objectives, the possible absence of financial support, European ambivalence, and Arab government concern over outside interference in their internal matters have led many to suggest that the Initiative will not turn out to be the catalyst for reform envisaged by the United States.^[6] While it is too soon to tell what role the Initiative will have in assisting modernization in the region, few would deny that reforms must be undertaken in one form or another if the region is to have any hope of providing an improved standard of living for its rapidly expanding population.

General Propositions

The main proposition underlying the Initiative is that as long as the region's pool of politically and economically disenfranchised individuals grows, we will witness an increase in extremism, terrorism, international crime, and illegal migration. It also cites the three "deficits" identified by the Arab authors of the 2002 and 2003 United Nations Arab Human Development Reports^[7]— freedom, knowledge, and women's empowerment -- as having contributed to these conditions. These propositions are backed up by a set of stark statistics taken from the U.N. report:

- The combined GDP of the twenty-two Arab League countries is less than that of Spain.
- Approximately 40 percent of adult Arabs—sixty-five million people—are illiterate, two thirds of who are women.
- Over fifty million young people will enter the labor market by 2010, one hundred million will enter by 2020—a minimum of 6 million new jobs need to be created each year to absorb these new entrants.
- If current unemployment rates persist, regional unemployment will reach twenty-five million by 2010.
- One-third of the region lives on less than two dollars a day. To improve standards of living, economic growth in the region must more than double from below 3 percent currently to at least 6 percent.
- Only 1.6 percent of the population has access to the Internet, a figure lower than that in any other region of the world, including sub-Saharan Africa.
- Women occupy just 3.5 percent of parliamentary seats in Arab countries, compared with, for example, 8.4 percent in sub-Saharan Africa.
- Fifty-one percent of older Arab youths expressed a desire to emigrate to other countries.

A second proposition, although one not explicit in the Initiative, is that due to the great diversity of socio/economic/political environments in the region broad generalizations as to the best programs for assistance are not particularly useful—what may be appropriate for Morocco, does not necessarily translate into a similar program for Saudi Arabia. Instead the focus here will be on a group of countries sharing a number of important similarities: the Gulf rentier states (Saudi Arabia, Iraq, Iran, Kuwait, Bahrain, Qatar, the UAE and Oman) together with Algeria. For this important group of countries the relative questions become:

1. What are realistic goals for the initiative? - As noted above, these are rather vague in the G-8 announcement. The discussions associated with the Initiative have generally fluctuated between two overlapping yet different objectives: democratization and development. The former goal focuses on political reform; the latter concentrates on basic socio-economic shortcomings. The empirical literature provides some insights as to where to focus the Initiative. One of the most robust, albeit controversial, findings of recent studies of the relationship between economic growth and democracy suggests that growth strengthens democratic states. Specifically, the work of Richard Posner shows that higher median incomes bring about greater political stability, perhaps because wealthier countries are better able to support a strong but more humane criminal justice and internal security system.^[8]

In a similar vein, Robert Barro has repeatedly found:

With respect to the effects of economic development on democracy, the analysis shows that improvements in the standard of living—measured by a country's real per capita GDP infant mortality rate, and male and female primary school attainment—substantially raise the probability that political institutions will become more democratic over time. Hence, political freedom emerges as a sort of luxury good.^[9]

The underlying argument is that, with rising incomes, societies become more willing—and more able—to pay for such things as clean air, better working conditions, and democratic governance. It suggests that consumers have a hierarchy of needs starting with the necessities of life and moving upward toward such comparative luxury items as political freedom.[10]

A related empirical finding of relevance is the manner in which countries manage globalization. To the extent that globalization contributes to national wealth, it promotes democracy and supports democratic institutions. To the extent that globalization gives rise to economic inequality, it leads to political instability and backlash against free trade, tariff hikes, and consequently slowed economic growth, hence decreasing rates of democratic consolidation.[11]

The transition economies of Eastern Europe and the former Soviet Union provide examples of economies drawing on reforms and globalization to achieve virtuous cycles of economic, social and political advancement. Unfortunately, another group of transition economies demonstrate the manner in which a vicious circle of decline can set in.[12]

Rather than focusing on democracy *per se*, the empirical patterns noted above suggest the attainment of ongoing progress in the economic, social, and political areas akin to that being attained by some of the more successful transition economies would be a realistic and satisfactory goal for the Initiative.

2. What are the main areas of reform needed to attain these goals? - The G-8 statement contains a long laundry list of usual areas in which reforms appear overdue and/or desirable on their own merit. However, all cannot (or should not) be undertaken at the same time and at the same level of intensity. Since we know what the more successful transition economies have done, this is largely an empirical issue—which reforms or combination of appear to be the most productive and in what sense in attaining advanced transition status?

3. What are the key differences between the individual rentier countries and how do these differences affect the application of the Initiative? While the rentier countries do share a number of important similarities that set them apart from other countries in the region, they also exhibit significant differences with regard to their level of development, progress in reforms and political development. In the context of the Initiative, a convenient summary measure of uniqueness might be something like the MENA report, Middle East Country Ratings. Each country's assigned rating is intended to convey the medium to long-term investment risk. The political assessment that accounts for two-thirds of the overall rating considers each nation's internal stability and susceptibility to external political and military threats. The commercial assessment, one-third of the overall all ranking accounts for each nation's macroeconomic performance and outlook, as well as government privatization efforts and other economic climate. A rating of eight or higher conveys a very attractive investment and commercial climate. A rating of three or less suggests significant investment risk.

For the main rentier countries (for around 2000):

- Algeria (3.3). Massive unemployment; dependence on oil and gas sectors; ongoing carnage.
- Bahrain (5.3). Suni-Shiite Strife; Gulf tensions; dependence on oil revenues; relatively untested leadership of Sheikh Hamad.
- Iran. (4.0) Growing internal political rifts; accelerating inflation and unemployment; huge black market; increasing student frustration.
- Iraq (1.8). Dilapidated infrastructure; continued U.N. Sanctions.
- Oman (5.6) Low employment of nationals; lack of economic diversity; dependence on foreign assistance.

- Qatar (6.2) strained inter-Arab relations; marginal non-oil sector.
- Saudi Arabia (5.6) growing internal opposition; overdependence on oil sector; sluggish economic growth.
- UAE (8.0) Increasingly tense relations with neighboring Iran; competition from other Gulf port hubs.

Are these differences significant enough to require a tailor-made program for each country? Or, in the bigger scheme of things, are the similarities across countries sufficiently uniform to justify a general approach, perhaps modified slightly by country?

Areas of Reform

One of the main lessons of the transition economies has been that progress in two key areas is critical for sustained economic growth and increases in the standard of living. Most of the countries that have been slow in adopting market-based economies and democratic political institutions and organizations have not regained the levels of output attained before the fall of Communism.

Economic Freedom

The Heritage Foundation/Wall Street Journal's annual Index of Economic Freedom provides a good measure of progress made in area of economic reforms.^[13] This index reflects the absence of government constraint or coercion on the production, distribution or consumption of goods and services. Stripped to its essentials, economic freedom is concerned with property rights and choice. To measure economic freedom the Index takes ten different factors into account:

1. Trade policy;
2. Fiscal burden of government;
3. Government intervention in the economy;
4. Monetary policy;
5. Banking and finance;
6. Capital flows and foreign investment;
7. Wages and prices;
8. Property rights;
9. Regulation; and
10. Informal market

Implied in these measures is the notion that economic freedom also requires governments to refrain from many activities. They must refrain from actions that interfere with personal choice, voluntary exchange, and the freedom to enter and compete in labor and product markets. Economic freedom is reduced when taxes, government expenditures, and regulations are substituted for personal choice, voluntary exchange, and market coordination. Restrictions that limit entry into occupations and business activities also retard economic freedom.

The index provides a framework for understanding how open countries are to competition, the degree of state intervention in the economy, whether through taxation, spending or overregulation, and the strength and independence of a country's judiciary to enforce rules and protect private property. Some countries may have freedom in all factors; others may have freedom in just a few. One of the most important findings of research carried out using the index is that economic freedom is required in all aspects of economic life. That is countries must score well in all ten of the factors in order to improve their economic efficiency and consequently the living standards of their people. ^[14]

Governance

A growing body of evidence points to governance failures as a root cause of slow and inequitable economic growth and as a defining characteristic of most poor countries. These findings justify placing governance high on any research agenda aimed at better understanding the political economy of development. Already, research into governance and development has had a notable impact: some dimensions of governance now sit at the center of academic and policy discussions of economic development.[15]

While the ranking of countries on the basis of their relative progress in attaining improved governance is inherently subjective, a recent World Bank study provides a set of rankings incorporating the full extent of our knowledge about this phenomenon.[16] More precisely, the World Bank data set presents a set of estimates of six dimensions of governance covering 199 countries and territories for 1996, 1998, 2000, and 2002.

Voice and Accountability. This variable measures various aspects of the political process, civil liberties, and political rights. These indicators measure the extent to which the citizens of a country are able to participate in the selection of governments. Also included in this variable are indicators measuring the independence of the media.

Political Stability and Absence of Violence. This governance cluster combines several indicators that measure perceptions of the likelihood that the government in power will be destabilized or overthrown.

Government Effectiveness. This variable combines aspects of the quality of public service provision, the quality of the bureaucracy, the competence of civil servants, the independence of the civil service from political pressures, and the credibility of the government's commitment to policies.

Regulatory Quality. This aspect of governance is more focused on the policies themselves. It includes measures of the incidence of market-unfriendly policies such as price controls or inadequate bank supervision, as well as perceptions of the burdens imposed by excessive regulation in areas such as foreign trade and business development.

Rule of Law. Included in this dimension of governance are several indicators that measure the extent to which the citizens of a country have confidence in and abide by the rules of society. These include perceptions of the incidence of crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts.

Control of Corruption. This dimension of governance measures perceptions of corruption. By this measure corruption is defined as the exercise of public power for private gain. It is often a manifestation of a lack of respect of both the corrupter and the corrupted for the rules that govern their interactions, and hence represents a failure of governance.

The measures of economic freedom and governance described above provide valuable insights to the progress made in laying the foundation necessary for sustaining high rates of economic growth and progress. More importantly, as the next sections suggest, certain combinations of governance and economic freedom appear more effective than others in this regard.

Progress Towards Economic Freedom and Improved Governance

As noted above, the comparisons of the patterns of progress in reforms achieved by the rentier and transition economies over the period 1995-2002 yield several interesting contrasts (Table 1):

1. The overall level of economic freedom (low numbers represent higher levels of freedom) achieved by the rentier states is greater than that attained by the low transition group. However the rentier economies progress towards economic freedom lags considerably behind the pace set by the high transition group.

2. Considerable diversity, however, exists within the rentier group, with Iraq having the lowest level of economic freedom followed by Libya, Iran, and Angola. In contrast, Bahrain (though declining slightly in the 2000s), the UAE, and Oman showed by far the most over-all progress in attaining greater economic freedom. In fact, in several areas, their progress was comparable to that attained by many Western European countries, as well as being well above most of the high transition countries.

3. Based on their relative progress in reform, the transition countries were split into two groups, a high group characterized by significant progress in both governance and economic freedom, and a low group experiencing significantly smaller gains in both areas. Both groups achieved fairly significant improvements in economic freedom between the late 1990s and early 2000s. Over this period, economic freedom improved by 6.2 percent for the low transition group while high transition countries averaged an increase of 9.6 percent. For the low transition group, every country except Belarus and Russia experienced improvements in overall economic freedom in the early 2000s. For the high transition group, only Romania suffered a setback in economic freedom during the 2000-2002 period.

4. At the same time, the rentier countries as a group experienced only marginal improvements (an average index increase of 3.49 to 3.46) in their economic freedom.

The progress made toward better government (higher values signify progress in attaining good governance) also produce some interesting contrasts between the three groups of countries.

1. Both the rentier and low transition groups are considerably below worldwide norm in the quality of governance, with rentier economies, on average, making better progress in this area.

2. In contrast to their incremental improvement in the economic area, the rentier countries greatly enhanced the quality of governance during the early 2000s (20.8 percent).

3. On the hand, the low transition countries suffered a decline in good government. The greatest gains in governance were achieved by the high transition group (51percent).

4. In general, rentier countries (with the exception of the UAE) scoring high in their attainment of economic freedom also made significant progress in the governance area.

Another pattern of interest is the contrast in per capita income growth. Here, there appears to be a fairly strong link between reforms and growth in the standard of living with the high transition countries, on average, experiencing higher and more consistent rates of growth than either the low transition or the rentier economies.

The components of both over-all indexes of reform also show considerable variation between groups of countries. In the economic area (Table 2), the rentier countries score quite high in their efforts in the monetary area, but have experienced the least progress of the three groups in the areas of government intervention, trade policy, and foreign investment.

In the governance area (Table 3) the rentier countries are the least advanced in voice and political stability with their main successes confined to the rule of law and to a lesser extent control of corruption.

Linkages Between Economic Freedom and Improved Governance

The aggregate patterns in economic freedom and governance suggest several group-specific linkages. In particular, the degree of governance attained in the late 1990s is a statistically significant determinant of the progress made at that time in the economic freedom area.^[17] The relative progress in each area also appears to condition the interaction between each area of reform. See [Figure 1](#).

In the late 1990s, the rentier economies over-achieved, scoring higher degrees of economic freedom than might have been anticipated from their progress in the governance area. As noted above, this group of countries had a fairly significant reform imbalance with economic freedom greatly outdistancing accomplishments in the governance area. On the other hand, the low transition countries as a group underachieved in the economic area. Their average economic freedom index (4.02) was considerably below that anticipated (3.86) on the basis of their quality of government. To a lesser extent (3.11 vs 2.99) the same is true for the high transition countries.

Reform imbalances in the late 1990s appear to have conditioned improvements in the economic freedom area in the early 2000s, with the rentier economies achieving less than anticipated expansion in economic freedom, while economic freedom in the transition economies increased at a rate higher than expected. For the 2000-02 period, this over-achievement in the economic area was marginal for the low-transition group, but considerable for the high transition countries.^[18]

Finally, changes in economic freedom in the early 2000s were a statistically significant determinant of improved governance during that period. Again, this effect varied by country grouping with both the rentier and high transition countries obtaining rates of improvement in government higher than might be anticipated, while governance lagged in the low transition group.

These patterns suggest that once the overall reform process reaches a certain stage, a certain momentum is built up, no doubt reinforced by improved rates of per capita income growth, that helps sustain improvements in both economic freedom and good government. The high transition group has certainly reached this stage and is now experiencing a virtuous circle of reforms—improvements in the economic area stimulates growth, which in turn makes reforms in the governance area easier. In turn, better governance, facilitates further advancement in economic freedoms.

However, the rentier countries do not appear to be quite at this point. One factor possibly responsible for this shortfall may be the manner in which oil revenues and associated government expenditures fluctuate—movements in these aggregates often mask the links between reform and improved standards of living. The result is that in good times there is often limited popular pressure and support for further reform. A contributing factor may be unanticipated shifts in oil revenues. Surges in oil revenues have certainly enabled several of the Gulf States to postpone painful reforms often on the verge of being implemented during periods of depressed oil markets.

Rentier States and The Transition Economies - Areas of Similarity

The patterns of reform in the rentier states and the transition economies suggest that the rentier economies exhibit similarities to both groups. Their reforms are at a more advanced stage than the low transition group. At the same time, they are approaching some of the more dynamic interactions between the reforms exhibited by the advanced group. In the net, which group are they closer to in terms of the overall reform environment? This is not a purely academic question. If the rentier countries are more similar to the low group, then we can easily identify the areas they need to focus on to create an environment similar to that of the high growth set of countries. On the other hand, if the rentier countries cannot be easily characterized as in one group or another, few of the lessons derived from the transition experience can be applied to their situation.

To assess the similarity of rentier countries with each of the two groupings of transition economies, several statistical tests were performed with their flow summarized in [Figure 2](#). First, since many of the

ten areas of economic freedom and the six of governance are closely related, an initial task was to identify the main independent areas of reform.[19] Five were found to characterize the reform effort (Table 4). In order of importance, they were: (1) government quality, (2) market reform, (3) government intervention, (4) fiscal policy and (5) monetary policy. In other words out of the sixteen standard reforms often discussed in the context of the Broader Middle East Initiative, only 5 are truly independent actions.

Governance/Economic Freedom Interactions - Empirical Links

Second, using these five reform dimensions to characterize the reform efforts of each of the rentier and transition economies, a profile of each group was created. In this regard, the most important dimension was governmental quality followed by government intervention, market reform, monetary, and fiscal policy. Overall, it appears that the rentier countries and the low transition countries have highly similar profiles.[20] All of the rentier economies, with the exception of Nigeria, were grouped with the low transition economies (Table 5). Significantly, most of the rentier countries were grouped with a very high probability (over 90 percent) of correct placement in the low transition group.

Third, one advantage of this approach is that group placement is assigned on the basis of a summary score (or index) related to reform efforts. For example, in the case at hand, Iraq had an extremely low level of reforms and thus was assigned a low negative score characterizing its reform efforts. On the other hand, the Czech Republic, having carried out an extensive set of reforms, had a high positive summary score. Somewhere between these two scores is a threshold value (based on reform efforts) that has to be reached for a country to be reclassified from a low transition to a high transition country.

Clearly some reforms will be more effective than others in lifting a country into the high transition group. Of the sixteen areas of reform, increased efforts in four appear critical: (1) rule of law, (2) voice and accountability, (c) banking and finance, and finally (d) foreign investment.[21] Interestingly, the two most important are in the area of governance, with economic freedom variables assuming a lesser, but still important role in advancing the countries along the reform path to a higher level of transition.

Assessment

Taken literally, the results noted above suggest that unless significant progress is made in the key areas of governance—especially rule of law and voice and accountability—in addition to economic reforms such as liberalization and strengthening of the domestic banking systems and increased openness to foreign investment, progress in the region will lag and the Initiative will likely fail. While reforms in other areas noted by the Initiative are no doubt desirable for their own sake, taken by themselves they are unlikely to be effective in creating an environment envisioned by the Initiative. Again this finding relates to the situation of the rentier states. Other areas of the Middle East are likely to require slightly different sets of reforms to advance their economies and societies. See [Figure 2](#).

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18. Regressing the residual obtained from the regression of economic freedom and governance in the 1995-199 period on the expansion of economic freedom in the 2000-02 period.
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21. Based on a regression analysis of the country discriminant score and its level of reform effort.