Have Oil Reserves in the Middle East Created Economic Modernisation and Political Stagnation?

https://www.e-ir.info/2012/03/28/have-oil-reserves-in-the-middle-east-created-economic-modernisation-and-political-stagnation/

CRAIG JACKSON, MAR 28 2012

The idea that "oil hinders democracy[1]" is almost axiomatic, with the oil producing countries of the Middle East and North Africa (MENA) region doing little to dispel this. Indra de Soysa finds evidence that suggests states with rentier economies, and specifically those based on resource exports, are far less likely to respect human rights and much more likely to use repressive measures to ensure domestic stability[2]. Auty agrees with this stating that countries dependant on natural resource rents are often associated with authoritarian political systems[3] and are more difficult to transform into democracies because they often have issues such as a surplus of labour, a corrupt government and are vulnerable to price fluctuations[4]. However Schlumberger shows that there are examples of oil producing countries that have developed both politically and economically (i.e. Norway and Venezuela) which seems to disprove the idea that oil can be blamed for political stagnation. Instead, he suggests that it is something specific to the MENA region that prevents political development rather than a universal trend[5]. Dauderstädt offers the most likely explanation for this discrepancy stating that the exploitation of a natural resource and the development of a rentier economy tends to strengthen and entrench the existing form of government.

In the case of the Middle East this means that states have remained autocracies because this is the form of governance that existed when oil was discovered. Countries that discover natural resources *after* stable, democratic institutions have been established are more able to develop both economically and politically[6]. It is therefore not the discovery of oil that has prevented political developments but the timing of the discovery. The discovery of oil can result in both economic modernisation and political stagnation for several reasons. Political stagnation is caused by external interest in the country and the development of a *Resource Curse* where countries are less likely to transit into democracies[7]. Economic modernisation occurs as large oil revenues allow countries to reinvest in and to diversify their economy.

The first issue I will address is that of the *Resource Curse.* Dauderstädt argues that resource rich countries are less likely to successfully make the transition to democracy. This is due to the creation of a small, but extremely wealthy political elite. In countries such as Saudi Arabia, where oil revenue accounts for eighty percent of its budget revenues and ninety percent of all exports[8], the governing elite is able to control the whole country by controlling only one domestic industry and because they control this source of wealth they are keen to maintain the status quo, not wanting to do anything that could result in them losing power and thus wealth. Consequently they use this oil revenue in a mixture of patronage and oppression to appease or control different sections of society[9]. Saudi Arabia has used its oil revenues to establish a fairly extensive welfare state providing housing, healthcare and education for its people[10]. However, because the money used to pay for this is not exacted from the people through a system of taxation these provisions are viewed as a gift from the government rather than a right.

The absence of a political link between the rulers and their people means that there is little opportunity for the middle-class, the vanguard of reform, to demand change. Due to the absence of a tax burden the middle-classes can easily be bought off by the government[11]. When there is little or no taxation, state institutions remain weak which allows for corrupt or selfish rulers to remain in place[12] because ruling elites in a rentier economy are not dependant on tax payer consent[13]. In this way oil can be seen to provide regime stability, even in autocracies, which undermines the modernisation theory that states that industrialisation will lead to a modern society both economically and politically[14]. In this way we can see that oil revenue has allowed the Saudi Arabian royal family to remain in power even as the country has industrialised and become more economically modern. The lack of any real political development to accompany this period of transition supports the idea that oil revenues permit economic modernisation but prevents the parallel political developments expected by modernisation theories.

Another way oil revenues prevent political modernisation is through the large amounts of money it enables countries to spend on their military and their secret police. By considering the ten highest military expenditures (by percentage of Gross Domestic Product [GDP] rather than total expenditure) eight are Middle Eastern countries, of which six have significant oil, oil shale or natural gas deposits[15]. This extensive defence spending gives the armed forces significant political influence and military based regimes are characteristics of many countries in the region[16]. Once the military has gained political influence it is appeased only through further military spending which creates a reinforcing cycle. Although the military was once seen as having a positive influence on development in the region now "whatever degree of order and discipline the military has been able to provide, it has been outweighed by the choking off of the free flow of information and ideas, and the blocking of the assumption of the responsibility on the part of the ordinary citizens for their economic and political affairs[17]." This shows how countries that spend large amounts of money in this way, but which lack strong political institutions, can often be controlled by their military which prevents political modernisation from occurring.

A more direct impact of having a large military is that it can often be used to repress large sections of society, particularly when it includes an extensive secret police which can be used to arrest and subdue both actual and potential dissenters. Saudi Arabia's Mabahith is an excellent example of this as they operate with impunity and are tasked with monitoring and arresting political opponents and suspected political opponents as well as dealing with more acceptable duties such as monitoring and investigating terrorist activities within the country. Nevertheless Mabahith has been associated with numerous human rights abuses including torture, arbitrary arrests and prolonged detention[18]. The idea that the secret police are above the law means that these countries do not and cannot enjoy rule of law, a key tenet of a politically modern society. It is therefore clear that large military expenditure is incompatible with political modernisation when the military is for and used against its own population.

The final factor I will address in regards to the political stagnation of oil producing countries in the Middle East is the fact they attract a large amount of external interest in their domestic affairs. Since oil was discovered in the region in the early twentieth century the West has sought ways to control the supply beginning with oil concessions, then providing aid and assistance to governments to secure access and later fighting wars to ensure they were able to safeguard their oil supplies. Initially oil supplies were controlled directly by Western companies but when oil industries were nationalised Western states had to find new ways to secure access to Middle Eastern oil particularly after OPEC showed its strength by raising oil prices by more than one thousand percent in the 1970s[19]. This is probably best seen by the many extensive arms sales to Middle Eastern oil producers for example in 1988 the UK signed a deal with Saudi Arabia involving the "sale of 72 Tornado fighters and 50 Hawk jet trainers, the construction of two airbases and a host of other equipment, training and spares.[20]" This was to be paid for with 600,000 barrels of oil per day. European countries also sold items such as tear gas and riot gear to Gadaffi despite the fact that these are designed to be used against civilian populations[21].

This causes political stagnation in the region as Western powers are willing to support stable but undemocratic regimes in order to secure access to oil. There have also been suggestions that the invasion of Iraq in 2003 was an attempt by the UK and USA to secure oil fields in Iraq and is supported by the discovery of memos which outlined plans by British government ministers to exploit Iraq's oil reserves the year before the country was invaded[22]. Although the invasion resulted in some political modernisation in the form of a limited democracy, there are reports of wide spread corruption throughout the country. Out of the billions of dollars in cash sent to Iraq to aid reconstruction, according to the Special Inspector General for Iraqi Reconstruction, "hundreds of millions if not billions of dollars . . . was stolen by senior Iraqi officials for their own personal gain.[23]" These levels of corruption hardly correspond with political modernisation so at best these small democratic gains are part of a superficial process of modernisation.

A good example of how oil revenue allows for economic modernisation is Kuwait. Kuwait produces an estimated 2.45 million barrels of oil per day[24] which provides it with revenue of $85.9 billion per annum[25]. In 1960 the government established the *General Reserve Fund* (GRF) which was financed by the growing budget surplus. This fund included all government investments including both foreign assets and shares in domestic companies. In 1976 a second fund was established named the *Reserve Fund for Future Generations* (RFFG) which initially consisted of 50% of GRF resources, 10% of all oil revenues and all additional income from government investments and assets[26].

This is a good example of economic development as it shows the government planning ahead in order to deal with the fact that its biggest source of income is finite and will eventually run out. The RFFG was used during and after the First Gulf War when oil production was halted and production facilities damaged[27]. Although this form of investment means that Kuwait still has a rentier economy it ensures that Kuwait will continue having a substantial income even when its oil wells run dry. This kind of future planning would not be possible without the large revenue oil brings in. Furthermore, because Kuwait's traditional industries were based around the extraction of natural resources (pearling and fishing[28]) oil revenue is probably the only way Kuwait could have safeguarded the future of their economy.

Despite this there are examples in the Middle East of oil producing countries that have seen both economic *and* political developments which undermines the idea that oil wealth prevents political modernisation. An example of a Middle Eastern country with vast oil revenues but which has still modernised politically (albeit not following a strictly Western model) is Kuwait. Kuwait is a constitutional monarchy and holds democratic elections to its National Assembly (KNA) every four years. Suffrage is universal with women being given the right to vote in 2005[29]. Admittedly the Amir does retain significant powers under this constitution but the KNA does have some legislative power[30]. Kuwait has established itself as an extensive welfare state offering many benefits for its citizens which are paid for by oil revenue as opposed to taxation. Kuwaiti citizens can enjoy a pension, housing loans, marriage bonuses, free healthcare, free education to any level and are almost guaranteed employment. Citizens also have the right to own real estate, share in publicly traded companies and majority stakes in business[31]. Kuwait may not have scored particularly highly in the 2010 democracy index but it moved up fifteen places since 2008. Kuwait is by no means an established democracy but it is strengthening its parliamentary system and reducing press censorship[32].

This shows that political developments are possible in the Middle East despite large oil revenues even if this development is not following a Western model. Kuwait has gained independence just over fifty years ago and in that time has made significant steps towards political modernisation but obviously this will not occur rapidly, Britain's constitutional monarchy evolved over almost one thousand years and involved numerous civil wars; to expect Kuwait to become a democracy over fifty years is unrealistic. The fact it has made what progress it has should be commended.

The next issue I will address is the negative impact that the discovery of oil can have on a country's economy. With a barrel of oil costing around $100[33] and the predicted demand for oil in 2012 rising to 90.5 million barrels of oil a day[34] a country that produces oil is likely to see a significant economic benefit. However, there problems arise when the economy becomes overly dependent on one source of revenue. The first problem that often arises after the discovery of oil is referred to as "the Dutch Disease." This is when large amounts of resource exports increase the value of the national currency making the country expensive to buy from. This reduces the competitiveness of other domestic industries and causes the collapse of those which would have otherwise stayed open[35]. On the whole this can result in lower economic growth in the long term. Indra de Soysa argues that whilst this effect can be countered through responsible fiscal policies but also notes that effective "policy cannot be simply willed into being,[36]" and as mentioned above, oil revenue often prevents efficient governance from being established.

The fact that other industries become less competitive and collapse results in the country becoming reliant on the oil industry which leaves the country vulnerable to price fluctuations and, because this industry employs relatively few people, can compound existing problems such as unemployment. Iraq's invasion of Kuwait in 1990 can be linked to the collapse in oil prices which occurred during the previous decade. Iraq was left extremely poor after its prolonged war with Iran and was struggling to rebuild its economy due to the low price of oil. Iraq accused Kuwait and the Emirates of producing more oil than was allowed by OPEC which forced prices down. Furthermore it accused Kuwait of stealing oil from the Rumaileh oil field in southern Iraq[37].

Whether or not these claims were true it shows how Iraq had become overly dependent on the oil industry and that this could have severe consequences on the country when the oil price dropped. Had Iraq's economy been built upon several industries then it would have been more robust and the First Gulf War may never have occurred due to the fact that many of Saddam's war aims were economically motivated. Had the Iraqi economy been stronger then arguably there would have been less of a need for Iraq to invade Kuwait. This all undermines the claim that oil reserves do result in economic modernisation. The IMF states that for a country to be classed as developed it must have a diverse economy and cannot be classed as developed based purely upon having a high GDP[38]. This reliance on one single industry is made worse by the fact that oil is a finite resource and some Middle Eastern countries, particularly Yemen, are predicted to run out of oil from as early as 2017[39]. If low oil prices can result in major economic disruptions then no oil revenue could result in the collapse of the whole economy of the Middle East.

The issues discussed above seem to suggest that there is something other than oil that prevents political modernisation in certain Middle Eastern countries. Schlumberger shows that both Venezuela and Norway have rentier economies based on oil exports but neither of them are autocracies[40]. He argues that Middle Eastern countries engage in rent seeking behaviour; rather than attempting to create wealth through the investment in other domestic industries, instead they seek to redistribute wealth which Auty states will prevent sustainable economic development[41]. If we look at countries like pre-war Iraq and Saudi Arabia they are clearly involved in rent seeking behaviour. Oil revenue accounts for over ninety percent of the Iraqi Government's total revenue and whilst there have been attempts to reinvest in other sector of Iraq's economy "widespread corruption, inadequate infrastructure, insufficient essential services, and antiquated commercial laws and regulations stifle investment and continue to constrain the growth of private, non-energy sectors[42]. This shows that countries without strong democratic institutions will struggle to modernise effectively due to a lack of transparency. Closed government allows for corruption which removes the incentive to both modernise economically and politically as this can limit the opportunities for money to be stolen or diverted. If countries have these institutions they tend not to engage in rent seeking behaviour which allows them to modernise.

It therefore seems likely that Dauderstädt is correct in his assertion that it is not oil that prevents political and economic modernisation but the timing of the discovery of oil reserves[43]. Most rentier states have already adopted a distinctive type of government before resources were discovered and exploited. As mentioned above, oil revenue generally provides stability. Consequently, Dauderstädt argues, states that found natural resources *after* democratic institutions were established remain stable and do not have to undergo any significant transitions. On the other hand, non-democratic states are given the means to stabilise their authoritarian regimes using oil revenue to prevent democratic change occurring within the country. Consequently it can be argued that oil does not always prevent political development, it just appears to in the Middle East due to the fact that non-democratic states were the norm in this region when oil was discovered.

In conclusion it seems that oil reserves neither guarantee economic development nor prevents political development. Oil has had an obvious impact on the Middle East but to give it sole credit for shaping such a complex geo-political region with a history spanning millennia is naive. Oil revenue can be used by governments to bring stability to their regime but the type of regime that exists is generally linked more closely to the nature of their independence movement rather than to the discovery of oil. We therefore see oil revenue being used to bring stability to a totalitarian monarchy in Saudi Arabia whilst at the same time we can see it being used to politically modernise the monarchy of Kuwait thus undermining the idea that oil revenue can have only negative effects on a political system.

Economic modernisation is often linked to the nature of a country's government. Where there is openness and democracy oil revenue can be used to revitalise and diversify the economy in order to make it truly modern. However in authoritarian states there is too much opportunity for corruption for the money to be spent wisely. This often leads to irresponsible fiscal policies which can damage rather than modernise the economy. Therefore it seems clear that oil revenue alone cannot be blamed for political stagnation in the Middle East nor is it a guarantee of economic development.

Bibliography

Auty, Richard M, 'Authoritarian Rentier States in the Broader Development Context' in *Dead Ends of Transition* Michael Dauderstädt and Arne Schilberg (eds) Campus, 2006

Blomstrom, Magnus, *Development Theory in Transition: The Dependency Debate and Beyond: Third World Responses* (London, 1984)John Bulloch and Harvey Morris *Saddam's War* (Faber and Faber Ltd, 1991)

Dauderstädt, Michael 'Dead Ends of Transition: Rentier Economies and Protectorates' in *Dead Ends of Transition* Michael Dauderstädt and Arne Schilberg (eds) Campus, 2006

Fasano, Ugo, 'Oil Funds as a Policy Instrument,' in *Dead Ends of Transition* Michael Dauderstädt and Arne Schilberg (eds) Campus, 2006

Ismael, Jacqueline S., *Kuwait*; *Dependency and Class in a Rentier State* (Syracuse University Press, 1982)

Milton-Edwards, Beverly, *Contemporary Politics in the Middle East 3rd Edition* (Polity Press, 2011)

Schlumberger, Oliver, 'Rents, Reform and Authoritarianism in the Middle East' in *Dead Ends of Transition* Michael Dauderstädt and Arne Schilberg (eds) Campus, 2006

Indra de Soysa, 'The Resource Curse: An Empirical Overview' in *Dead Ends of Transition* Michael Dauderstädt and Arne Schilberg (eds) Campus, 2006

https://www.cia.gov/library/publications/the-world-factbook/geos/sa.html (07/01/12)

http://portal.mofa.gov.sa/Detail.asp?InSectionID=1516&InNewsItemID=1746 (09/01/12)

https://www.cia.gov/library/publications/the-world-factbook/rankorder/2034rank.html

http://www.hrw.org/legacy/backgrounder/mena/saudi/ (08/01/12)

http://www.guardian.co.uk/world/2006/dec/15/bae.saudiarabia (10/01/12)

http://www.guardian.co.uk/news/datablog/2011/mar/01/eu-arms-exports-libya (10/01/12)

http://www.independent.co.uk/news/uk/politics/secret-memos-expose-link-between-oil-firms-and-invasion-of-iraq-2269610.html (10/01/12)

https://www.cia.gov/library/publications/the-world-factbook/rankorder/2173rank.html (13/12/11)

http://www.menafn.com/qn_news_story_s.asp?storyid=1093434970 (13/12/11)

https://www.cia.gov/library/publications/the-world-factbook/geos/ku.html (10/01/12)

http://www.e.gov.kw/sites/kgoenglish/portal/Pages/Visitors/AboutKuwait/GoverningBody_TheGovernment.aspx# (10/01/12)

http://www.state.gov/r/pa/ei/bgn/35876.htm (10/01/12)

http://graphics.eiu.com/PDF/Democracy_Index_2010_web.pdf (09/01/12)

http://www.bloomberg.com/energy/ (13/12/11) http://omrpublic.iea.org/ (13/12/11)

http://www.imf.org/external/pubs/ft/weo/faq.htm#q4b (08/01/12)

http://articles.latimes.com/2010/jan/05/opinion/la-oe-fontaineexum5-2010jan05 (06/01/12)

https://www.cia.gov/library/publications/the-world-factbook/geos/iz.html (09/01/12)

http://www.usatoday.com/money/economy/story/2011-10-29/cnbc-iraq-money/50979276/1 (18/03/12)

[1] Oliver Schlumberger, 'Rents, Reform and Authoritarianism in the Middle East' in *Dead Ends of Transition* Michael Dauderstädt and Arne Schilberg (eds) Campus, 2006 pg. 100

[2] Indra de Soysa, 'The Resource Curse: An Empirical Overview' in *Dead Ends of Transition* Michael Dauderstädt and Arne Schilberg (eds) Campus, 2006 pg.55

[3]Richard M Auty, 'Authoritarian Rentier States in the Broader Development Context' in *Dead Ends of Transition* Michael Dauderstädt and Arne Schilberg (eds) Campus, 2006 pg.36

[4] Ibid., 46

[5] Oliver Schlumberger op. cit., 100

[6] Michael Dauderstädt 'Dead Ends of Transition: Rentier Economies and Protectorates' in *Dead Ends of Transition* Michael Dauderstädt and Arne Schilberg (eds) Campus, 2006 pg. 15

[7] Ibid., 14

[8] https://www.cia.gov/library/publications/the-world-factbook/geos/sa.html (07/01/12)

[9] Dauderstädt op. cit., 16

[10] http://portal.mofa.gov.sa/Detail.asp?InSectionID=1516&InNewsItemID=1746 (09/01/12)

[11] Indra de Soysa op. cit., 49

[12] Ibid., 50

[13] Dauderstädt op. cit., 13

[14] Magnus Blomstrom, *Development Theory in Transition: The Dependency Debate and Beyond: Third World Responses* (London, 1984) 43

[15] https://www.cia.gov/library/publications/the-world-factbook/rankorder/2034rank.html (09/01/12)

[16] Beverly Milton-Edwards, *Contemporary Politics in the Middle East 3rd Edition* (Polity Press, 2011) 111

[17] Ibid., 112

[18] http://www.hrw.org/legacy/backgrounder/mena/saudi/ (08/01/12)

[19] Beverly Milton-Edwards op. cit., 92

[20] http://www.guardian.co.uk/world/2006/dec/15/bae.saudiarabia (10/01/12)

[21] http://www.guardian.co.uk/news/datablog/2011/mar/01/eu-arms-exports-libya (10/01/12)

[22] http://www.independent.co.uk/news/uk/politics/secret-memos-expose-link-between-oil-firms-and-invasion-of-iraq-2269610.html (10/01/12)

[23] http://www.usatoday.com/money/economy/story/2011-10-29/cnbc-iraq-money/50979276/1

[24] https://www.cia.gov/library/publications/the-world-factbook/rankorder/2173rank.html (13/12/11)

[25] http://www.menafn.com/qn_news_story_s.asp?storyid=1093434970 (13/12/11)

[26] Ugo Fasano, 'Oil Funds as a Policy Instrument,' in *Dead Ends of Transition* Michael Dauderstädt and Arne Schilberg (eds) Campus, 2006 pg.97

[27] Uga Fasano op. cit., 98

[28] Jacqueline S. Ismael *Kuwait*; *Dependency and Class in a Rentier State* (Syracuse University Press, 1982) 102

[29] https://www.cia.gov/library/publications/the-world-factbook/geos/ku.html (10/01/12)

[30]http://www.e.gov.kw/sites/kgoenglish/portal/Pages/Visitors/AboutKuwait/GoverningBody_TheGovernment.aspx# (10/01/12)

[31] http://www.state.gov/r/pa/ei/bgn/35876.htm (10/01/12)

[32] http://graphics.eiu.com/PDF/Democracy_Index_2010_web.pdf (09/01/12)

[33] http://www.bloomberg.com/energy/ (13/12/11)

[34] http://omrpublic.iea.org/ (13/12/11)

[35] Indra de Soysa op. cit., 49

[36] Indra de Soysa op. cit., 49

[37] John Bulloch and Harvey Morris *Saddam's War* (Faber and Faber Ltd, 1991) 100

[38] http://www.imf.org/external/pubs/ft/weo/faq.htm#q4b (08/01/12)

[39] http://articles.latimes.com/2010/jan/05/opinion/la-oe-fontaineexum5-2010jan05 (06/01/12)

[40] Schlumberger, op. cit., 100

[41] Auty, op. cit., 47

[42] https://www.cia.gov/library/publications/the-world-factbook/geos/iz.html (09/01/12)

[43] Dauderstädt, op. cit., 15

—

Written by: Craig Jackson
Written at: Lancaster University
Written for: Robert Smith
Date written: January 2012