PROBLEMS OF SOCIOECONOMIC DEVELOPMENT IN THE OIL-RELIANT COUNTRIES OF THE MIDDLE EAST

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I. Introduction

Use of oil as a means in the process of economic development has been one of the main purposes of the governments of the *Middle Eastern oil-reliant countries* since the early 1950s. Oil was seen as a source of cheap energy and large amounts of revenues, which were necessary for implementing major development strategies such as industrialization. However, the amount of oil revenues that they planned to use in their economic development was not as high as they had expected it to be. This was the beginning of the first period of their development, which covers the decades of 1950s and 1960s.

This period can be characterized by low rate of surplus in oil exports and problems with capital accumulation. Indeed, during this period many of these countries resorted to foreign borrowings from international economic institutions and private financial institutions. But they could not solve their problems and were going into balance of payments difficulties.

As a remedy to these troubles they tried to increase oil revenues and the only way of doing that was to increase the quantity of oil, because they were not able to increase price of it due to the fact that they had no say in international oil pricing system. In fact, between 1961-1969 the quantity of oil exported by these countries increased threefold.[1] However, the revenues did not increase in the same percentage with quantity, because when they were increasing quantity, the price of oil was decreasing further due to the excess supply. In order to avoid continuous price reduction they established Organization of Petroleum Exporting Countries(OPEC) and Organization of Arab Petroleum Exporting Countries(OAPEC) in

1960 and 1968 respectively, but they could not solve this problem until the early 1970s.[2] Thus, in the first period governments of the Middle Eastern oil exporting countries could not do much for the economic development.

The second period of their development started with an important event –1st Oil Shock. After 1971 and 1973 dollar devaluations, and outbreak of Arab-Israeli war in the October of 1973, there emerged an atmosphere in which they could increase the price of their oil nearly four times. Thus, after the 1st Oil Shock, with the quadrupled oil revenues the economic planners of these states had great opportunities for implementing major development projects. Indeed, they did so, but by the mid-80s, when oil revenues were decreasing, they could not continue with state-sponsored development projects and turned to stimulate private sector for the economic development.

In the last period of their development (from mid-80s onwards) governments of these countries extended credits to private sector and put forward quasi-liberalization policies for continuing development process. But within a few years after the beginning of this period it was realized that nothing was going as expected, the private sector didn't wake up and the economic development remained to be problematic.

Was it a curse, a bad luck or a consequence of wrong development strategies?

II. Economic Development: Aims, Activities, and Consequences

Most of these states emerged or were "created" in the same period of history and all were living through the same stage of economic development. Therefore, development aims were nearly the same in all of them. These aims can be generalized as follows:

- increasing living standards,
- promoting domestic development,
- reducing dependence on oil and the West through domestic diversification and external investment.[3]

They relied on oil and oil wealth for the achievement of these aims. However, from the beginning of the process there have been appearing many severe problems. The dimensions of the problems of development in the Middle Eastern oil-reliant economies can be divided into two categories: *external* and *domestic*. But even some problems of purely domestic nature were bound by the external factors, events and concerns. This can be explained by the fact that in comparison with the other regions of the world, the Middle East has been subjected to a wider penetration and interference by external powers, which could be easily felt not only in the economy of the Middle East, but in its politics and military affairs as well.

Domestic Dimensions

The first domestic problem was the ***rural – urban migration.*** This began well before the time when those states started to gain high oil revenues, and its negative effects have always been there until today. With the starting of the massive exploration of oil, people began to migrate from rural areas to big cities in order to get well-paid jobs for meeting their living needs. The migration had two important impacts on the social-economic structure of those countries. First, agriculture, which was a traditional sector of productive activity, declined. People who were considered as skilled labor in agricultural activities, suddenly became unskilled in big cities. As skilled labor is more efficient than unskilled one, the number of efficient workers within their economy decreased. Second, when they left agriculture, the production of agricultural goods, particularly that of food, decreased abnormally which in turn gave a rise to the import of those products and as an outcome of this their dependence on outside world increased.[4]

Another set of domestic problems was related with ***state subsidization.*** Even before the inflow of high oil revenues, people's hope in these countries was that oil money would solve all problems. Moreover, there was a common belief among the population that the state as the owner of all revenues should subsidize every aspect of economic life including consumption.[5] In fact, in Iraq, Kuwait, Libya, Saudi Arabia, Qatar and UAE food, fuel, water, electricity and other consumer necessities were highly subsidized by state. The prices of imported goods and goods of the nationalized industries were subsidized as well.[6] The governments of these countries applied a loose taxation system or did not collect tax at all. This has been one of the main characteristics of rentier states, such as the Gulf monarchies, in which the monarchs or the leaders have been using oil wealth for subsidizing economic necessities of the population in order to consolidate their rule through achieving the consent and loyalty of people. In brief, oil affluence made it possible for them to pursue "distributive" other than "extractive" financial and fiscal policies.[7]

Since the state made these payments from the budget and since income part of the budget depended solely or mostly on oil revenues, when oil revenues were increasing, payments to these areas and to the public sector employees were increasing either. So, cash surplus at their disposal was increasing. As a pattern of typical consumer behavior they extended the range of goods and services that they were willing to buy. In 1979 aggregate consumption in Algeria, Iraq, Kuwait, Qatar, Libya, Saudi Arabia, and UAE constituted more than 40% of their GDP. It was also observed that 90% of the total consumption were imported goods.[8]

All these had effected their economies negatively; First, more consumption brought about less saving, which means less money to invest in the economy. Second, more imports led to the higher levels of dependence on advanced nations. And third, when oil revenues started to decrease in the early 80s, there arose many problems in implementation of "distributive" policies on which the economic life of a large part of the population was dependent.

Their ***industrialization strategy*** also constituted many problems that reduced the effectiveness of their development projects. As a remedy to their industrial backwardness they applied the theory of late industrialization. And industrialization process, be it early or late, needs capital accumulation to be achieved as the first and primary stage. Capital accumulation has two aspects: machinery and financing. With the latter they had no problem thanks to high oil revenues which quadrupled after 1st Oil Shock. However, with the former there was a big problem. Since they were technologically backward, they had to buy all the needed machinery from the advanced countries. Nevertheless, as the financial part of their capital accumulation was dependent on oil revenues and oil revenues themselves depended on sales to Western countries, the process of industrialization as a whole was conditioned by ups and downs in the economies of advanced countries.[9]

Indeed, in the late 70s - early 80s, when Western countries shifted to other sources of energy such as natural gas, and/or reduced the import of the Middle Eastern oil by substituting Latin American and the Northern oil to it, the revenues of the Middle Eastern oil exporters decreased considerably and consequently, they had to stop or postpone the implementation of some major development projects which were financed from the budget. Thus, their industrialization as a whole process became dependent on the outside world.[10]

It is obvious that the dependency was brought about not only by the rational energy policies of the Western states towards them, but the wrong policy choices of state economic planners who pursued misleading economic strategies also contributed to it.

The economic planners, by and large, thought that the only way of catching up with the advanced countries was to industrialize in the areas that they had specialized in. This, they thought, would decrease imports, and therefore, decrease dependency. In addition, they realized that with the export of raw materials and primary products, and the import of highly technological and more sophisticated commodities, in other words, with the export of cheap and import of expensive goods, the terms of trade between them and advanced countries were favorable to the latter. In order to change these terms of trade in favor of themselves they wanted to reduce the import of hi-tech products. Accordingly, they tried to create and develop sophisticated industries of their own. In so doing, the importance of agricultural production was neglected and most of the available resources were devoted mainly to the improvement of highly sophisticated industries.[11] They advocated the idea of *Import Substitution Industrialization* without analyzing whether they had comparative advantage in those industries or not. Within that context they argued for the protection of infant industries until they were able to compete with foreign firms.

But all these ideas were incompatible with the realities of the day. First of all, *Infant Industry Argument* proved to be false. As those industries were continuously protected by the state vis-à-vis foreign firms, they got used to the state support and never became competitive. Second, the original aim was to reduce imports so that the dependency would decrease. But when they shifted factors of production from agriculture to industry, traditional agricultural activities in which they had comparative advantage were abandoned. As a result of this, agricultural production diminished, and instead, import of those products increased. This time, they became dependent on the Western states not only in highly sophisticated products but also in their basic consumption needs such as food.[12]

Moreover, they put forward industrialization in the areas in which they hadn't got not only enough experience and specialists, but also enough input. An effective industrialization process is the one which combines different domestic industries that use each other's products as input. In such process the value added within economy is increased, which is a sign of high domestic integration. But the case of these countries was different. They wanted to specialize in the industries that they weren't cognizant to and that didn't lead to domestic economic integration. Some of them could do this only in the petrochemical industry, but even in petrochemicals they could hardly compete with the leading countries such as Norway, the United Kingdom and the United States.[13]

Finally, there was ***confusion of growth with development*** in the minds of the economic planners of these states. It is worth to note that in many of the Middle Eastern oil exporting countries growth was confused with development. As they were already conditioned to living on their capital assets, they used to look at their increasing revenues as a rise in their real income. Accordingly, they accommodated their habits and institutions to the modern standards of consumption.[14] With the oil revenues paying the bill, they became addicted consumers of expensive Western products. In other words, the availability of oil revenues made it easy for them to buy ready-made products rather than to meet the opportunities for improving domestic production and fostering domestic and regional economic integration.[15]

It was apparent that they were growing: national income and living standards were rising, infrastructure, health services, educational system, etc., were improving. During 1970s the growth was around 15% in most of the Middle Eastern oil exporting countries. In Saudi Arabia it was about 18 % for five years (1974-1979).[16] However, the growth in these countries was indexed to oil revenues which depended on the price and the quantity of oil exports. So, the growth was a dependent one and an increase in it brought about an increase in dependency on Western economies. To put it otherwise, they could increase their income but tied both income and development to the economies of advanced nations. For this reason, the economies of oil exporting countries could be easily influenced by the fluctuations in the economies of the oil importing countries. In brief, the growth was not a factor stimulating development by reducing dependency, on the contrary, it was a misleading trend which was increasing their dependency on external actors and factors.

External Dimensions

The development of the Middle Eastern oil exporting countries was characterized with problems not only in domestic arena but also in their external orientations.

A myriad of these problems was related with the ***external capital–investment schemes***. It's worth to begin with a statistical data about the issue. According to 1983 statistics, only $30 billion of $300 billion total Arab capital holdings were in Arab banks. No one Arab bank was in the top 100 world banks either in assets or in revenues.[17] The Arabs invested the surplus coming from oil revenues in portfolios in both developed and developing countries. But generally they preferred Western banks. The USA had the largest share in the cumulative inflow of capital from Arab oil exporting countries. 22,7%

of total Arab capital exports were invested in the US assets between 1974-1983.[18]

The reasons of why they did not invest at home but invested abroad are various. The major reason was that investment in Western assets seemed less risky. Moreover, during these years the governments of the Middle Eastern countries kept interest rates lower than the world level in order to stimulate investment. As investment at home was not promising much and was very risky, and as interest rate at home was lower than in Western states, the Arab capital holders preferred to invest abroad, because it was less risky and more beneficial.

This affected the home economies of the Arab capital holders negatively. First of all, by investing abroad they put their investment under the economic and political pressures of foreign governments. A drastic change in the fiscal and monetary policy of the host country could effect the net earnings of these capital holders. The political pressure of those governments could also have an impact on the status of that investment.[19] For example, after the Iranian Revolution the US government seized all the assets owned by Iran in the American banks. The Arab investment in these banks were as vulnerable as that of Iran was. In addition, in 1970s there was a negative real interest rate in the western countries. This resulted in the erosion of the assets owned by the Arab capital holders over a long period.[20] Thus, the surplus money which they gained through oil exports and invested in Western banks was loosing its real economic value over time. In other words, they were the losers in the real economic terms.

Apart from these, since many of the above mentioned countries tried but could not specialize in the capital-intensive industries, they remained in the labor-intensive ones. This was not so problematic for some of them such as Iraq and Algeria, because they have a large labor force. While many of them with small labor force such as Kuwait, Qatar, Saudi Arabia and UAE had to import the needed number of workers in order to manage the problem of labor shortage. In some of these countries the share of ***expatriate labor*** as a percentage of total labor force was more than a half. For instance, in Kuwait and Qatar it was about 60% in 1983.[21] Saudi Arabia has been by far the largest importer of labor in the Middle East. Usually they imported labor from non-oil-exporting Arab countries such as Egypt, Jordan and Yemen, and from the Muslim countries of the Indian subcontinent such as Indonesia, Pakistan and Malaysia. The basic logic behind that was the similarity between the peoples of these countries and the oil exporting countries of the Middle East due to the common culture, ethnic identity and religion, which made it easy for them to establish communication and adapt to each other's traditions and way of life.[22]

This movement of labor had some important impacts on the economies of both labor exporting and labor importing countries. The expatriate workers send their earnings to home in order to support their families. The money flowing outside in this way, which is called ***labor remittances***, is a big loss for the host economy, whereas, a big gain for the home economy of the expatriate labor. For instance, in 1983, the profit of Egypt from labor remittances was about 89% of its gains from merchandise. For Jordan it was 175%.[23] So, the outflow of money as labor remittances is a big problem. But a bigger problem is that these countries have to rely on the expatriate labor, which is an external economic and social element, for the sake of sustaining their own economic development.

III. Concluding Remarks

In the final analysis the problems of economic development in the oil-reliant countries of the Middle East can be characterized as follows: First, people's dependence on state as the initiator, promoter and monitor of economic activities has been very high. Since in most of these states the governments applied "distributive state" model, every aspect of economic life was sponsored or subsidized by state. As a result of this, the private sector did not develop to higher standards and therefore, nearly all segments of society became dependent on the state in economic terms.

Second, the states themselves became dependent on oil revenues, not only in their long-run development projects, but also in their current consumption needs. In most of them oil industry and oil-related industries have been dominating the economy. Consequently, the other industries and economic activities have been heavily depending on the oil industry and the revenues gained through oil exports. In other words, they could not diversify their economy and decrease dependence on oil. Indeed, most of the economic problems that these countries have been suffering from since late 1980s were mainly related with non-diversified structure of their economy.

And the last, oil exports were tied to the external actors and factors. A substantial part of their oil has been imported by the nations of the West. It was forecasted by many scholars that if oil-importing countries increased efficiency in their energy use or shifted to other energy sources such as atomic energy, this would certainly result in many severe problems in the oil-reliant economies of the Middle East.[24] In fact, this has been the case since mid-80s.

As they have been the exporters of one commodity and the importers of many, their economy became dependent on the outside market forces. Their revenues and foreign assets have been very much vulnerable to the monetary and fiscal policies of other countries. In terms of military hardware supplement they again have relied on the external actors, especially on the Western states.[25] Given these conditions and factors, one may argue that not only their economic development but also their high-politics issues such as security, have become vulnerable to external forces. Probably, with so much vulnerabilities these countries will not be as affluent and secure in the next decades as they were in the past ones.

NOTES

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