To what extent has oil proved an obstacle to the development of strong states in the Middle East?

The consequences of the discovery of oil in the Middle East have been many and most of them have made some describe the resource as a “curse”. The excessive dependance of the countries in the region on the revenues from the oil-extraction have become an obstacle to state development and social reforms. I will demonstrate this trough the framework of the rentier state and Ayubi's weak state thesis. My focus will be mainly on the oil-producing states, where I believe these effects are much more intense. I will complement my argument with the examples provided by Saudi Arabia and Kuwait.

The discovery of oil in the Middle East has extensively affected the domestic political order of the countries in the region, turning them into what we refer to as rentier or semi-rentier states (Luciani, 2005: 91). While in the western based model, the state is supported by its citizens' taxes, in the oil-producing countries, the revenues of this activity support the state (Luciani, 2005: 91). Beblawi argues that there are three elements that define a rentier economy. The first is that, while no economy is entirely dependent on one single export, rentier states are predominantly dependent on revenues from a single activity (Beblawi, 1990: 87). In the case of Middle Eastern rentier states, that activity would be oil production. The second element is that the origin of the rent must be external to the country (Luciani, 2005: 92). This idea of external rent is crucial to the paradigm as it means that it can sustain the state without the need for a strong domestic sector (Beblawi, 1990: 87). The third element is the fact that only a small portion of the population is engaged in the the rent's generation (Beblawi, 1990: 87). The majority of the population is engaged in the usage of these revenues, although most of the wealth is concentrated in the upper echelons of society (Beblawi, 1990: 87). The fourth and final element of the rentier state is the concentration off all the revenues in the state *per se* (Beblawi, 1990: 88). An important aspect that marks the difference between the rentier states and the semi-rentier economies of the region.

Most non-oil producing countries have become dependent of the remittances sent by their expatriates, working in the oil producing ones. These remittances are concentrated in the private sector and the government would require taxation to gain access to them, which is contrary to the external notion of the paradigm (Luciani, 2005: 92).

The rentier character of Middle Eastern states accounts for much of what we perceive as a weak state, specifically if we use Ayuibi's thesis. In his book, *Over-stating the Arab State*, Ayubi describes the countries in the Middle East as "quasi-states" given their disproportionate development (Ayubi, 1994: 12). Given that the concept of state is imported from the West, different from the regional political system, its bureaucratic body has become oversized (Ayubi, 1994, 12-13). While it may have developed excessively in some aspects – in its economic and military activity, for example - it is under developed in others (Ayubi, 1994: 12). Amongst those neglected areas are the extractive and regulatory bodies of the state.

The first big inflow of oil revenues into these states happened in the 1970s with the first oil boom (Luciani, 2005: 92). These revenues kept growing for a decade, to such an extent that they represented 90% of these states' exports (Beblawi, 1990: 89). This sudden growth had a damaging and enduring effect in the process of state building that was also taking place. The regulatory, extractive and distributive institutions grew disproportionately, with the latter assuming greater importance (Chaudhry, 1989: 103).

Oil rents made these states acquire a distributive nature and relinquish what Chaudhry considers to be the most important tool of the modern state, its "power to tax" (Chaudhry, 1989: 103). This has effects not only on the extractive capabilities of the state but also on its regulatory capacity. As Chaudhry argues, the decline of these institutions has broad effects on other bodies (Chaudhry, 1989: 113). The extractive branch helps the state fiscal apparatus gather information. The absence of this economic data leads to uninformed policy choices and state spending that will hamper the effectiveness of regulations put in place, as well as the way in which oil wealth is distributed (Chaudhry, 1989: 113-114). Chaudhry's analysis coincides with Ayubi's weak state thesis by highlighting some over and under developed bureaucratic bodies of the state.

When analyzing the extractive and redistributive, or just distributive, mechanisms of Middle Eastern states, oil can be seen as having a negative impact, contributing to their weakness, according to Ayubi's framework.

The absence of taxation and its distributive nature made Middle Eastern states financial independent from society (Luciani, 2005: 93). This has had negative results on institutional development, economics and domestic policy. The effect, on the latter, was mostly one of suppressing the evolution towards a more representative political system. The rentier paradigm reversed the popular slogan from “no taxation without representation” to “no representation without taxation” (Luciani, 2005: 93). Since it does not tax its citizens, the state acquires legitimization through the distribution of wealth, be it through improved welfare, education and housing for the masses, or favors and gifts to key strategic political allies (Noreng, 2003: 12).

The rentier state solidified its position through a system of patronage, by purchasing the loyalty of certain groups (Gause, 1994, 43). Governments fomented the rise of a new private sector that was, from the start, dependent of the state for funding and subsidies (Gause, 1994, 43). The government also became the major employer – working for the government became an objective for every citizen (Beblawi, 1990: 91). This government becomes the major economic actor, intervening in both the public and private sector.

As Luciani argues, this is why rentier states have been able to sustain themselves without strong opposition (Luciani, 2005: 93). Smith shares this same argument and, through his own study, adds that oil has become an important tool for Middle Eastern rulers to prolong their existence (Smith, 2004: 242). These regimes have evolved in a way that makes them unlikely candidates for the rise of social unrest or civil war (Smith, 2004: 242). An analysis that, however, does not mean that these states are not weak, taking into account Ayubi's framework.

As Smith notes, despite their ruler's resilience and the regimes' longevity, oil has been significant in maintaining weak institutions and preventing important economic reforms (Smith, 2004: 243). The distinction between “regime” and “state” becomes important to the argument. Despite the apparent stability of some of these countries, a close look at their policies and institutions contradicts the very notion of a strong states.

The resilience of these regimes can be explained by the patronage system that, despite supporting the regime, does, however, have a weakness: it is dependent on the state's capacity to channel oil wealth to society. As Noreng argues, in the face of declining oil revenues, the new class refuses to give up the privileges it was conceded. (Noreng, 2003: 14) During recession period of the 1980s, Arab states tried to liberalize their economies in response to the decline of oil prices but the private sector, accustomed to its subsidies, saw reform as a threat to its status-quo (Chaudhry, 1994, 10). The patronage system that supports the state refused to concede and the government was forced to cut on the poorer echelons, that are already under pressure (Noreng, 2003: 14). The over inflation of the distributive bureaucracy, as mentioned in Ayubi's thesis, has this problem. It acquired such a dominant presence in the economy that business elites became unwilling to surrender their privileges. The state's strong involvement in the economy means that its legitimacy becomes linked with the state's economic success (Ayubi, 1994: 31-32). Thus, the state is weakened as an economic crisis will turn into a “crisis of the state”. (Ayubi, 1994: 32).

The patronage system did not limit itself to the new technocratic class and expanded into the military. Motivated by the political instability in the region, Middle Eastern states spend an average of 5.2% of their GDP on military equipment, well above the world average of 2% (SIPRI, 2010). With the rise of spending in personnel, equipment and facilities, the sector acquired its own interests and political influence (Noreng, 2003: 12) Like the other technocrats, the military lobbied for extra funding and privileges, and became another “conservative force” of these regimes (Noreng, 2003: 12). Once again we see Ayubi's weak state thesis at play here, with the “over inflation” of this specific sector.

This complex system implemented in rentier states is designed to maintain the regime's longevity but it is unsustainable in the long term. The state becomes increasingly vulnerable not only to changes in oil prices, with direct impact on revenues, but also to demographic change. The strong investment that has been made in education has produced a new generation that has nowhere to apply its skills (Noreng, 2003: 22). Youth unemployment in the Middle East has now reached 23,7%, the second highest rate in the world, only behind North Africa (Deloitte, 2010, 14). This new surge of educated unemployed youth can generate social unrest throughout the region, unless governments show the will to adopt political, social and economic reforms that open and diversify the economy (Noreng, 2003: 23).

Another way to look at the frailty of this system is that the state's huge involvement in the public and private sectors, essential to every day life, will lead to a bigger demand for participation (Gause, 1994: 81). Citizens will want to make sure that institutions which play such a huge role in their lives are well managed (Gause, 1994: 81). I will demonstrate the presence of these elements with the application of the rentier state thesis to the examples of two Gulf states, Kuwait and Saudi Arabia.

Case Study: Kuwait

	Kuwait
Unemployment	n/a
Youth (Population under 24)	41,7%
Youth Unemployment	23,3%a
Democracy Index (0 to 10)	3,88
Democracy Rank (out of 167)	114
Military Expediture (% of GDP)	3,6%

Table 1: Source:The Economist Inteligence Unit. a – Deloitte.

Kuwait was the first state in the Gulf to introduce the system where the government distributed part of the oil revenues to the population (Beblawi, 1990, 90). It started with the development of the public sector to provide enough jobs not only for Kuwaitis but also for the educated migrants that flocked to the country and invested in the creation of free welfare services (Owen et al, 1998: 214-215). The third measure, designed to seduce elite Kuwaiti families, was the purchase of land, above market value, thus creating as system of patronage and a social support for the state (Beblawi, 1990: 90). The government distributed 2.2 billion Kuwait dollars this way, at least half of which went to members of the royal family and their political allies (Owen et al, 1998: 215). This was the method that would later be replicated throughout the region.

When it comes to its economic policy, Kuwait can be seen as one of the better examples. The country experimented with its own industrial sector, financed by oil revenues, but, the small size of the local market and the high wages of local employees made Kuwaiti products uncompetitive (Owen et al, 1998: 215). The government only gave up on the industrialization strategy in the 1980s, when it realized it could obtain higher returns if it invested oil revenues in other country's industries (Owen et al, 1998: 215). The new strategy proved effective during the oil busts of the 1980s. Earnings from overseas investments softened the impact that the decline in oil prices had on the economy and Kuwait managed to grow 3% a year (Owen et al, 1998: 216).

In terms of democratic representation, Kuwait is number one amongst oil-producing Middle Eastern states - excluding Iraq (EIU, 2011). However good in comparison to other Gulf states this result may be, it is still represents a very low score on a worldwide scale (see Table 1). Although the country has a long standing tradition of representative institutions, the monarchy has managed to successfully suppress them on numerous occasions (Gause, 1994: 90). Opposition comes mainly from the parliament but the monarchy has kept the final word in most issues (EIU, 2011: 20). The recent wave of unrest throughout the Middle East, know as the Arab Spring, was successfully quelled through a handout of 1,000 Kuwaiti dollars and free food to every citizen (EIU, 2011: 25). Political instability lead to a spike in oil prices which gave governments the capability to, once again, buy the legitimacy of their rule (EIU, 2011, 22).

However, the state's fast growing population and the high level of youth unemployment (see Table 1) suggest that sooner or later the state will have to reform itself. Oil revenues will not be able to subsidize the living of a fast-growing educated population (EIU, 2011, 25).

In the military, the country maintains a high expenditure (see Table 1), which also contributes to the disproportionate charterer of state institutions. However, spending is not that high when compared to other Middle Eastern countries.

Case Study: Saudi Arabia

	Saudi Arabia
Unemployment	10,8%
Youth (Population under 24)	50,2%
Youth Unemployment	25,9%a
Democracy Index	1,84
Democracy Rank (out of 167)	160 of 167
Military Expediture (% of GDP)	10,1%

Source:The Economist Inteligence Unit. a – Deloitte.

The case of Saudi Arabia is of particular importance because of the sheer magnitude of its oil reserves, the largest in the Middle East. However, prior to 1970, Saudi economy was still very small, compared to other Middle Eastern countries (Sinclair et. al., 1982: 198). Saudi Arabia had yet to turn its economy towards oil-extraction, to a point that the annual pilgrimage to Mecca was still a significant source of income for the state (Sinclair et. al., 1982: 199). Revenues from the pilgrimage had already allowed the government to establish a small system of patronage that expanded, later, with the rise in oil revenues of the 1970s (Beblawi, 1990: 90).

The rise in income allowed the government to eliminate the existing taxes, completing the transformation of Saudi Arabia into a distributive state in the early 1970s (Owen et al, 1998: 207) During this period, oil revenues rose from 333.7 million dollars, in 1960, to 104.2 billion dollars in 1980, accounting for more than 90% of the governments income in the early 1970s (Owen et al, 1998: 210). Other economic activities like agriculture and trade soon became irrelevant in comparison to the oil industry (Owen et al, 1998: 210).

Saudi economic development followed the same path as Kuwait and tried to diversify its revenue portfolio by investing in industrial development (Sinclair et. al., 1982: 205-206). However, unlike Kuwait, the Saudi government believed that domestic investment served the countries interests better, because it allowed the state to maintain complete control of its assets (Sinclair et. al., 1982: 206). Large amounts of money were invested in agriculture and industry but the cost of production remained high, five times the world price in some agricultural cases (Owen et al, 1998: 213). The private sector became parasitic, highly dependent on the government's subsidies and protection from foreign competition (Owen et al, 1998: 213). The objective of diversifying the state's revenues was therefore spoiled.

In terms of political activity, Saudi Arabia has only demonstrated the openness to adopt a more participative system after major events in the region, namely with the Iraqi invasion of Kuwait (Gause, 1994: 94). Several petitions calling for more participation circulated in the 1990s that demanded the creation of independent local “consultative councils” that would wield real powers (Gause, 1994: 117). Steps were taken in that direction, but the ruling family's willingness to accommodate consultative councils has not extended to actually sharing power (Gause, 1994: 117-118). The current situation of the country has not shown much improvement since the 1990s as Saudi Arabia is the most autocratic regime in the Middle East, and one of the most in the world (see Table 2). The policy-making process is dominated by the ruling family in collaboration with the clergy elite (EIU, 2011: 21). The government has been able to silence the few calls for democracy that arose with the Arab Uprisings, using the same tactic as Kuwait (EIU, 2011: 24). Initiatives included two months of extra wages for public sector workers, unemployment benefits and the construction of 500,000 housing units (EIU, 2011: 24). These giveaways amount to 30% of the country's GDP and were possible because of the rise in oil prices (EIU, 2011: 22-24).

However, as in its Gulf neighbor, the situation is bound to change. The fast growing population will soon render the state incapable of providing jobs and welfare in these same terms (EIU, 2011, 25).. The system of patronage keeps growing with an increasing number of families whose allegiance the state has to accommodate – the royal family now has about 2,000 princes (Sinclair et. al., 1982: 198). Unemployment and youth unemployment are worse than in Kuwait (see Table 2) and oil revenues will, at some point, become insufficient to sustain the entire population and the state will have to reform (EIU, 2011, 25).

One of the reasons Saudi Arabia has been able to maintain its system has to do with its military spending, totaling 10.1% of the country's GDP, more than any other country (SIPRI, 2010). The military is also part of the patronage system, as the regime depends on its support for survival (Noreng, 2003: 17). The excessive amount spent on the military has made the government cut the investment in other areas, such as health and education, in years of slower economic growth (Noreng, 2003: 17).

Conclusion

As we have seen, oil has contributed to the under development of some government branches – extractive and regulatory - and the over development of others – distributive and military. Regimes in the Middle East have endured because of it but remain weakened by complex social, political and economical issues. These states are in danger of collapsing if no reforms are made to open the economy and provide employment to their fast-growing populations. Oil has been one of the major drivers of this outcome as this analysis and the two examples demonstrate.

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