

**Oil and Development in the Middle East**  
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**Abstract**

This paper examines the political economy of oil in the Middle East and employs a fresh comparative perspective to answer a question of wider interest: how do natural resources shape paths of economic and political development? While this topic has attracted considerable analytical and empirical research, the related analyses on political economy and natural resources have tended to neglect systematic analysis of the Middle East, which is the global resource-rich region *par excellence*. This paper seeks to fill these analytical and empirical gaps through a multi-layered, but rigorous, narrative of the political economy of the Middle East. It first reviews the global literature on natural resources, institutions and development; then distils from the literature a theory of rent cycling; and finally employs the theory to evaluate Middle East deployment of the 1973-82 and 1999-2009 revenue windfalls. The paper argues that the oil curse is an intense variant of a broader 'rent curse' that incentivises elites to prioritise patronage over economic growth, which: heightens rent dependence; sustains a patrimonial form of capitalism; acutely distorts labour markets; and ossifies autocratic governance that is brittle. Moreover, the regional spill-over from cycling the oil rent has helped entrench rent-seeking in the labour-surplus economies, whose elites too retard economic reform and therefore the competitive diversification of the economy that drives both productivity-driven growth and political maturation.

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## 1. Introduction

This paper reflects on the political economy of oil in the Middle East and North Africa (MENA) and proposes a fresh comparative perspective that focuses on a question of wider interest: how do natural resources shape paths of economic and political development? While this topic has drawn considerable analytical and empirical interest from researchers, the related analyses on political economy and natural resources have tended to ignore systematic analysis of the Middle East, the global resource-rich region *par excellence*. This paper fills the analytical and empirical gaps through a multi-layered, but rigorous, narrative of the political economy of the Middle East that is set in the broader context of a *rent* curse, within which the resource curse and oil curse are subsets.

The paper argues that the oil curse is an intense form of a broader rent curse that can also be caused by foreign aid (geopolitical rent) and government manipulation of prices (regulatory rent) and worker remittances (labour rent) as well as by natural resource rent. The strength of the oil curse reflects the unusually large scale and capital intensity of oil extraction, which renders streams of oil rent: (i) exceptionally large (and volatile) relative to most national GDPs, and (ii) strongly concentrated on the government. The paper argues that the scale and the degree of dispersal of the rent systematically shape the political economy.

The paper draws on rent cycling theory whose basic insight is that rent that is low or dispersed across many economic agents (and therefore hard for the elite to extract) motivates the elite to grow the economy efficiently in order to boost their income and expand the tax base (since the elite tend to benefit disproportionately from tax expenditure). These incentives elicit a distinctive policy response that moulds the development trajectory, which in turn shapes the development trajectory of the political economy. Specifically, a strategy of economic growth calls for the provision of public goods and maintenance of efficiency incentives, which as explained below promote the competitive diversification of the economy that proliferates social groups that drive political change.

In contrast, high rent, especially when it is concentrated on the government, triggers contests among the elite for its capture, which yield more immediate and larger personal gains for the elite than growing the economy does. In consequence, much rent is allocated politically via patronage networks at the expense of markets. The resulting repression of markets distorts the economy, which lowers investment efficiency and retards competitive structural change and PCGDP growth compared with the low-rent development trajectory. It also consolidates autocratic government that is brittle.

The argument is developed in three stages. The next section, Section 2 analyzes the global literature on natural resources, institutions and development. Section 3 then synthesises the literature into a theory of rent cycling that identifies and explains contrasting trajectories of the political economy in terms of differences in the scale and dispersal of rent across economic agents. Section 4 evaluates the deployment of MENA oil rents through the 1973-83 and 1999-2009 oil booms, and argues that both booms failed to shift the economy from rent-dependent growth to productivity-driven growth. Section 5 concludes.

## 2. The Literature

Academic speculation about the existence of a natural resource curse was fuelled by case study analysis of the deployment of the 1973-82 oil windfalls, which revealed mostly disappointing outcomes (Gelb 1988, Karl 1997). Sachs and Warner (1995 and 1999, 23) triggered a series of systematic statistical analyses. They identified Dutch disease effects as the driver of the curse whereby the revenue stream from the booming commodity strengthens the real exchange rate, which causes the non-booming tradeable sectors (agriculture and manufacturing) to contract so that when commodity prices eventually fall the economy may be less prosperous than it was before the boom occurred. Sachs and Warner also find that most natural resource-rich governments close their trade policy as their dependence on primary product exports increases in order to counter the employment-diminishing effects of Dutch disease, a policy that facilitates extraction of regulatory rent.

Interestingly, the trade policy/resource export dependence curve traces an inverted U-shape because at very high levels of resource dependence trade policy re-opens. This reflects the dominance of the oil-rich Gulf monarchies among the high-dependence countries, which were indifferent to employment destruction by imports because their unusually high rent per head supplied sufficient revenue to subsidise the livelihoods of nationals, including the provision of public sector employment. But a more common response among commodity exporters, including most other oil exporters, was to protect manufacturing and deploy rent for state-led industrialisation, much of which was inefficiently executed and unprofitable (Auty 1990). Lal and Myint (1996) show how protectionist policies repress markets and competition so that the economy is distorted, investment efficiency wanes and economic growth collapses.

More recently, Acemoglu et al. (2001, 2002) argue that the quality of institutions is more important than natural resources *per se* in determining whether resource rents are a blessing or a curse. In particular, they identify as detrimental to economic growth those extractive colonial institutions associated with colonies that were too unhealthy for significant European settlement. Melhum et al. (2006) conclude that strong (production-friendly) institutions incentivise economic agents to invest rent productively whereas weaker institutions expand rent-seeking. But Glaeser et al. (2004) relegate institutions to secondary status: they find that institutions improve as a consequence of rising incomes but do not cause that rise, which is explained by human capital and policy choice.

Khan (2000) goes further and identifies a *political* imperative for governments of emerging economies to deploy rent in order to establish and maintain political cohesion, without which economic activity struggles. He notes that the resulting patronage-driven rent deployment is likely to result in policies that are economically sub-optimal. North et al. (2009) usefully model the political economy that causes such outcomes as Limited Access Order societies. These are societies that deliberately create and/or capture rent and deploy it to co-opt and thereby neutralise those deemed capable of wielding violence. Limited Access Societies typify developing economies and contrast with the Open Access Societies that characterise most OECD countries and offer broad access to political and economic opportunity.

Acemoglu and Robinson (2008) subsequently back-track on their earlier findings and recognise the ability of the elite in emerging societies to manipulate institutions. In such

societies, institutions bend to accommodate political incentives rather than mould those incentives (World Bank 2009). Schlumberger (2008) argues that in oil exporting countries the pursuit of political cohesion spawns a patrimonial form of capitalism in which informal institutional rules override formal rules when this benefits the elite recipients of rent. The prime features of patrimonial capitalism are: (i) the dominance of informal institutions over formal ones; (ii) the application of formal rules to discipline elements disloyal to the regime (which weakens respect for the rule of law); (iii) the emasculation of market reforms where, as with competition policy, it limits scope for patronage; (iv) property rights that are guaranteed by patronage and require significant social investment by participants; (v) higher transaction costs than in a competitive market economy; and (vi) opposition to democratic governments by rent recipients who support a 'shadow' political system that selectively applies the informal rules and institutions to benefit the elite.

Schlumberger's patrimonial capitalism offers an explanation for the *persistence* of autocratic regimes in the MENA region, with due allowance made for the operation of regional pressures for conformity of political regimes (O'Loughlin et al. 1998). However, the *origin* of autocracy within the MENA region is variously attributed to: (i) the cultural legacy of Islam (Kuran 2004); (ii) the legacy of colonialism; and (iii) the role of oil rent in reducing government taxation and associated demands for accountability and in limiting participation of women in the economy (Ross 2008). Kuran (2004, 271-2) identifies three Islamic institutions that he considers to have blocked the emergence of a business environment of comparable dynamism to that in northwest Europe. The three institutions are: Islamic inheritance law, which limited scope for capital accumulation; the strict individualism of Islam, which worked against the notion of the self-sustaining and risk-sharing corporation; and a concept of social trust, the *waqf*, which locked resources into organisations that proved to be prone to become ossified and dysfunctional over time. Kuran is probably correct in regarding under-developed competitive markets and immature private sectors as being responsible for the political economy gap with the West, rather than the institutional legacy of colonial exploitation, which dominated explanations by MENA scholars in the 1960s and 1970s but did not impede, for example, Singapore and Hong Kong.

Rentier state theory attributes the distinct MENA political economy to a more recent set of forces associated with oil rent. Beblawi and Luciani (1987) argue that rents weaken democracy in two basic ways. First, rent furnishes governments with sufficient revenue to diminish their financial reliance on domestic taxes, which reduces political pressure for government accountability (Ross 2001). Second, resource rents strengthen the ability of the government to neutralise opposition by buying it off or by repressing it by force (Henry and Springborg 2000). However, Haber and Menaldo (2009) conclude from an exhaustive analysis of country cases and statistical analysis that, 'Regime types are not determined by natural resource wealth. This is not to say that there may not be cases where a dictator has held onto power by using resource wealth. It is to say that the evidence does not support generalizable, law-like statements--even conditional ones'.

Haber and Menaldo (2009) help confirm the case made by Lederman and Maloney (2007) that statistical analyses of the resource curse remain inconclusive, but both believers in the resource curse and sceptics miss a more fundamental flaw in such research. The statistical analyses ignore the fact that other revenue streams can replicate resource curse symptoms. This implies that the symptoms can manifest themselves in resource-poor economies like the Sahel. It suggests that at the very least the statistical studies contain much background noise and at worst they are fatally flawed. The other revenue streams comprise foreign aid, regulatory rent and wage remittances, which share the property with natural resource rent

of conferring windfalls on rent recipients. Moreover, natural resource rent itself can be subdivided into two categories with potentially different outcomes (Table 1), namely, rent that is concentrated on a handful of companies and governments, as typically occurs with mineral rent, and rent that is dispersed across many economic agents, as with peasant cash crop rent (Isham et al. 2005). Diffuse rent is more conducive than concentrated rent to both economic and political development (Baldwin 1956; Bevan et al. 1987).

Foreign aid is a geopolitical form of rent that can replicate resource curse symptoms. Boone (1996) finds from data for 1970-90 that foreign aid did not increase the investment rate in recipient countries but went mostly into consumption and expanded government. Moreover, the increased consumption did not benefit the poor in any of the three types of political state that he analysed (autocratic, egalitarian and oligarchic laissez-faire). Rajan and Subramanian (2011) find that domestic expenditure of aid within the public sector triggers Dutch disease effects that stifle labour-intensive manufacturing. Table 1 suggests that development outcomes from aid are equivocal due to variations in the rigour of donor aid supervision.

Regulatory rent is created by governments manipulating relative prices, which may extract not just the rent from economic activity but also part of the return to capital and labour. It thereby represses producer incentives while its expenditure often expands subsidised activity (Tollison 1982). It also tends to be concentrated (Table 1): Krueger (1992) reports large transfers from peasant farmers towards urban elites in sub-Saharan Africa during the 1970s and 1980s through the abuse of crop marketing boards, which transformed the beneficially diffuse crop rent into concentrated rent that was deployed inefficiently.

Finally, wage remittances comprise a diffuse form of rent that boosts domestic consumption, often of the poorest and also funds investment where financial systems are under-developed (Giulano and Ruiz-Arranz 2009). The positive impacts of remittances on economic growth appear to attenuate however, as financial intermediation improves and the adverse effects on work incentives strengthen as incomes rise. Moreover, large remittance flows can trigger Dutch disease effects that may depress long-term growth (Rajan and Subramanian 2011).

The literature therefore suggests that the resource curse is a variant of a broader rent curse that can also manifest itself in resource-poor economies in receipt of streams of foreign aid, regulatory rent and remittances. Moreover, concentrated streams of rent, notably mineral rent and regulatory rent but also foreign aid in some circumstances are potentially damaging to the political economy whereas diffuse rent streams are potentially beneficial. Consequently, the dominance in the MENA region of oil rent, which is amplified by the re-circulation of oil rent as foreign aid and wage remittances into local labour-surplus countries, renders the region well-suited to a systematic investigation of the rent curse.

### **3. Systematic Patterns in the Political Economy of Rent-Driven Development**

The emerging theory of rent cycling can help to explain rent-driven development. It is distilled from the development literature (Auty 2010) and argues that differences in the scale of rent relative to GDP along with its distribution across economic agents (Isham et al. 2005) and its volatility (van der Ploeg 2011) systematically mould the elite incentives that shape the policies, which drive the trajectory of the political economy. Although economists argue that high rent can accelerate economic development by raising the rate of investment

and expanding the capacity to import capital goods to build modern infrastructure, such gains are more than offset if high rent incentivises the elite to enrich itself by creating political patronage through the repression of markets. The corollary is that low rent may, paradoxically, be more advantageous for development than high rent if low rent incentivises elites to grow the economy in order to boost their incomes and expand tax revenue, the expenditure of which tends to benefit the elite disproportionately. The contrasting rent-driven development trajectories are next each reviewed in turn. The low-rent development trajectory provides an instructive counter-factual for the high-rent trajectory.

### 3.1 The Low-Rent Competitive Industrialisation Model

Rent cycling theory posits that low-rent triggers four basic circuits (incentive, economic, social and political) that drive rapid economic growth and structural change, which rapidly boost material welfare and proliferate social groups that contest power and mature the political system. Figure 1 summarises the stylised facts. First, as just noted, low rent incentivises elites to grow the economy which requires the provision of public goods and the maintenance of investment efficiency. This aligns the low-rent economy with its comparative advantage in exporting labour-intensive manufactures. Second, the early expansion of labour-intensive manufacturing rapidly absorbs surplus rural labour so that rising wages drive *competitive* diversification into skill-intensive and capital-intensive sectors to boost productivity and sustain rapid PCGDP growth.

Third, early industrialisation entails early urbanisation, which accelerates the demographic cycle so the dependent/worker ratio falls, which raises both saving and the share of investment in GDP so that per capita GDP growth accelerates (Bloom and Williamson 1998). In addition, the elimination of surplus labour puts a floor under the wages of the poor while skill proliferation caps the skill premium so economic growth is relatively egalitarian as well as rapid (Londono 1996). This nurtures a self-reliant social capital rather than government-dependent social capital.

Fourth, fast GDP growth drives rapid structural change that expands independent social groups that contest political power and thereby restrict policy capture by any one group (Lizzeri and Persico 2004). Rapid structural change also strengthens three sanctions against anti-social governance as: firms protect their investment by lobbying for property rights and the rule of law (Li et al. 2001); unsubsidised urbanisation strengthens civic voice (Isham et al. 2005); and in the absence of sizeable rents, governments rely early on taxing income, profits and expenditure, rather than on windfall revenue from rent, and tax reliance spurs demand for accountable public finances (Ross 2001). Rent cycling theory argues that the interplay of the four circuits propels incremental shifts to mature the economic and political systems.

### 3.2 The High-Rent Staple Trap Model

In contrast, the high-rent trajectory heightens the risk of locking the economy into a staple trap that triggers a growth collapse from which recovery is invariably protracted (Figure 2). Taking the same four circuits, first, high rent incentivises the elite to compete for rent so rent flows through patronage channels at the expense of competitive markets because patronage offers more immediate (often personal) rewards than the long haul of building wealth through economic growth, whose benefits may accrue to others. The focus on patronage discounts economic goals relative to political goals so the economy is distorted and becomes locked into a staple trap of increasing reliance on subsidies that eventually outstrip supply. Second, the deployment of rent for patronage causes investment efficiency to decline and the rent to be absorbed too quickly into the domestic economy, triggering Dutch disease effects. This encourages governments to subsidise employment in jobs that

markets would not support in protected industry and an over-expanded bureaucracy.

Third, Dutch disease effects also cause the economy to skip the low-rent model's phase of labour-intensive industrialisation so that surplus labour persists and widens income inequality. The deployment of rent to expand unproductive employment augments demand for transfers, so that social capital is increasingly rent-dependent rather than self-reliant. Fourth, decelerating structural change retards the proliferation of social groups capable of contesting political power. In addition, strong reliance on patronage weakens sanctions against anti-social governance because businesses benefit more from lobbying politicians for rent than from productive investment; social capital remains rent dependent; and government reliance on rent rather than direct taxes eases demands for fiscal accountability.

The high-rent system sustains an autocratic government that is brittle and allocates rent to the elite for political reasons at the expense of economic policy. Absent economic reform, which rent recipients resist, the development trajectory triggers a growth collapse that is protracted due to rent recipients' opposition to reform. In these circumstances, the provision of geopolitical rent to help revive a collapsed economy may be counter-productive if it merely perpetuates elite incentives for rent-seeking. Otherwise, the system eventually self-corrects after a growth collapse because sustained high population growth squeezes per capita rents until elites are finally incentivised to espouse policies to grow the economy.

In addition to the two basic development trajectories, rent cycling theory recognises variants due to different combinations of initial conditions. More specifically, rent cycling theory recognises that the adverse impacts of high and concentrated rent from whatever source are exacerbated (and therefore more intractable) in the presence (i) statist policies, (ii) high ethnicity and (iii) parliamentary democracies that are (iv) young. Briefly, statist ideology amplifies the adverse effects of high rent by boosting scope for governments to override markets (Van der Walle 1999). Ndulu et al. (2008) identify regulatory regimes as the dominant anti-growth syndrome behind the disappointing performance of sub-Saharan Africa since independence.<sup>1</sup> For example, governments in peasant farm societies can expand political patronage by abusing crop marketing boards to convert the beneficially dispersed rents into concentrated rents, which are deployed economically less effectively than rent dispersed across many economic agents (Baldwin 1956, Bevan et al. 1999).

Ethnic tension reinforces elite incentives to use rent for political patronage. Montalvo and Reynal-Querol (2005, 294) find ethnicity is negatively associated with the rate of investment, the rate of economic growth and the quality of government. With respect to governance, Collier and Hoeffler (2009) find that in the presence of high rent autocracies outperform democracies in terms of economic growth whereas the reverse is true with low rent. They suggest with regard to mineral rent that high rent makes it politically more profitable for democratic governments to channel public revenue into patronage to secure the support of swing votes, rather than into providing public goods, which confer no electoral edge since they benefit supporters and opponents alike.

Finally, with significance for the Arab Spring, Keefer (2007) finds that young democracies are less successful than either autocracies or established democracies because they cannot make credible pre-election promises to voters. Consequently, political parties in young democracies under-provide non-targeted goods that benefit all (like universal education, property rights or access to information) and over-provide targeted goods (like employment and public work projects), which favour key voting blocs (which corrupts).

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<sup>1</sup> The other syndromes are ethno-regional redistributive regimes, inter-temporal redistribution regimes and failed states.

#### 4. Impact of Rent Streams on MENA Political Economy

This section applies rent cycling theory to compare the impacts of the 1973-82 and 1999-2009 oil booms on the MENA economies. Three main groups of economy can be recognised based on their per capita oil endowment: capital-surplus oil exporters, capital-deficient oil exporters and labour-surplus (Table 2)<sup>2</sup>. The capital-surplus oil exporters have in common sufficient hydrocarbon reserves to generate revenues in excess of those that their domestic economies can absorb. In contrast, the population/reserve ratios of the capital-deficient oil exporting economies render them capable in theory of absorbing more capital than their oil reserves generate (Nankani 1979). Finally, the labour surplus economies are impacted indirectly by the oil booms because they export labour to oil-exporting economies and receive investment and foreign aid from them<sup>3</sup>. Table 2 traces the impacts of fluctuating prices on the size of the MENA oil rents relative to GDP by country. Overall, the capital-surplus oil exporters' share of oil exports in GDP through 1975-2008 fell modestly by 4% to 58%, whereas the share for the capital-deficient oil-exporters jumped from 18% to 39% over the same period, the reverse of what they required (World Bank 2011c).

Rent cycling theory predicts that elites in low-rent economies face strong incentives to grow the economy by providing public goods and maintaining competitive markets, whereas the elite in capital-surplus oil-exporters compete for rent that risks over-rapid rent absorption leading to a growth collapse. The risk of over-rapid rent absorption was highest during the 1973-82 boom because the windfall was larger, relative to GDP. Although according to Villafuerte and Lopez-Murphey (2010, 4), the peak prices for oil were similar, at \$95/barrel expressed in terms of US\$2009 in 1980 and 2008, the 1973-1982 price rise was markedly stepped whereas prices rose initially slowly and also incrementally through 1999-2008. MENA oil revenue therefore surged after the 1973 oil shock quadrupled prices and the 1979 shock abruptly doubled them again. In addition, the deployment of the 1999-2008 windfall might be expected to reflect a learning curve and engender a more cautious response from the elite.

##### 4.1 The 1973-1982 Boom and Subsequent Bust

The public sector was the principal vehicle for windfall deployment during the 1973-82 boom in all three sets of economy, whether through direct expenditure of oil revenue by the oil-exporting governments or indirectly in labour-surplus economies in the form of foreign aid, wage remittances and transfers of regulatory rent. The rent was deployed to strengthen on-going state-led development strategies, which reflected the widespread belief of the MENA elite that the private sector was insufficiently developed to drive economic diversification. The larger oil-exporting economies pursued resource-based industrialisation (RBI) via petrochemicals or energy-intensive metals production. The strategy wrongly assumed both that downstream processing automatically had comparative advantage and that the private sector would invest in processing RBI outputs downstream, which would be labour-intensive (Auty 1990). In addition to RBI, the capital-scarce oil exporters also promoted import substitution industrialisation behind protective tariffs, much of which remained uncompetitive.

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<sup>2</sup> On the eve of the 1999-2009 oil boom, MENA endowments of oil reserves per capita ranged from 12-45 million barrels in capital-surplus oil-exporting economies to below 2 million barrels for capital-deficient economies.

<sup>3</sup> The labour-surplus economies may be further subdivided into those with modest hydrocarbon resources that confer oil booms of limited duration (Egypt, Syria, Sudan and Yemen) and resource-poor economies with negligible hydrocarbon production (Jordan, Morocco and Tunisia).



The oil-exporters absorbed their rent too quickly into the domestic economy during the 1973-82 oil boom, triggering Dutch disease effects that accelerated the contraction of farming, aborted labour-intensive industrialisation and proliferated service employment, notably in the public sector, which was over-expanded and often over-remunerated. The capital-surplus economies in particular developed levels of social entitlement that entrenched a rent-dependent social capital and proved difficult to maintain. The oil-exporting countries, and even some labour-surplus economies, developed dualistic labour markets, with nationals preferring the superior pay and perks of the public sector to private sector employment, which was left mainly to lower-paid immigrant labour.

Paradoxically, the MENA labour-surplus economies generated sufficient aggregate rent to fund state-led development through the 1970s, which expanded protected manufacturing, often state-owned, and boosted rent-seeking by the elite, while failing to competitively diversify the economy. Several labour-surplus economies generated significant rent from hydrocarbon exports: Egypt and Syria since the late-1970s and Yemen from 1990 and Sudan from 2000 (Table 2). In addition, foreign aid boomed in the late-1970s (Table 3). It helped Jordan to absorb repeated influxes of refugees and insulated Yemen from pressure to boost productivity. Jordan drew additional rent from remittances, which averaged one-fifth of GNI annually 1975-2004. Yemen also relied heavily on remittances before switching to oil dependence in 1990. Egypt enjoyed the highest aggregate rent that averaged 30-40% of GDP until the late-1990s (Tables 2 and 4) whereas at the other extreme Tunisia drew around 10% of GDP annually in rent.

Energy conservation eventually cut global demand for oil so the rent faltered after 1981 and declined from 1985, but the response of the oil-exporting governments was tardy. Although investment was quickly curtailed, the generous social entitlements proved politically difficult to cut back. As rent cycling theory predicts, rent-recipients exhibit strong inertia and are reluctant to forgo entitlements. Governments initially assumed that the oil price fall was temporary and borrowed rather than cut social entitlements. The governments first ran down their accumulated reserves but then borrowed to finance their fiscal deficits: debt jumped from one-fifth of GDP to three-quarters 1990-96 (IMF 2011a, 4).

One expenditure cut that the oil-exporting governments made promptly in the mid-1980s was in foreign aid. This coincided with falls in remittances and hydrocarbon rents in the labour-surplus economies (Tables 2 and 4), which were unable to sustain debt accumulation as long as the oil-exporters. Consequently, in the late-1980s the governments of labour-surplus economies requested IMF assistance that came with conditions requiring economic and political reform. Elite rent recipients captured the reforms, however, and adapted them to their advantage. They welcomed privatization as an opportunity to acquire state assets cheaply but they then slowed the expansion of competitive markets in order to sustain their regulatory rent. Even Tunisia, with the lowest aggregate rent, succumbed to the rent curse (Anderson 2006, Sidiki 2002): economic reform decelerated after some growth in labour-intensive export manufacturing so PCGDP growth failed to match the rates of Asian competitors (Table 4). The debt/GDP ratio of the labour-surplus economies exceeded that of the oil-exporters and for far longer, fluctuating at 80 to 105% of GDP through the 1990s and 2000s.

Nevertheless, the MENA labour-surplus countries grew faster than the oil-exporters through 1971-2000 and narrowed the per capita income gap that, ironically, had widened in the 1960s when oil prices were lower (Table 4). Even so, the deployment of rent through 1973-

82, whatever its origin, distorted the political economy of all three groups of MENA economy and consolidated a distinctive regional syndrome that exhibited: (i) persistent rent-dependence, (ii) autocratic regimes, (iii) weak private sectors and (iv) distorted labour markets.

#### 4.2 The Post-1999 Boom

Although the 1999-2009 boom was smaller relative to GDP than the earlier boom and slower to take off, MENA oil revenue grew almost four-fold from \$200 billion annually 2000-02 to \$700 billion by 2007<sup>4</sup> (IMF 2008). The fiscal revenue of the oil-exporting governments jumped from \$130 billion per year to \$510 billion and the MENA oil exporters' cumulative fiscal surplus for 2004-08 approached \$1 trillion. There is evidence of a learning curve, which manifest itself in higher saving of the windfall, slower domestic absorption and greater reliance on markets. But the option to make the fundamental and necessary reform from rent-dependent development to productivity-driven development was shunned. Instead, patrimonial capitalism tamed market reforms; timid experiments with democracy languished so autocratic governments persisted; and labour markets remained dualistic and inefficient.

Most oil-exporting governments responded prudently to the mid-2000s windfall revenue and treated it as temporary and an opportunity to reduce government debt and to increase reserves. Total MENA government debt fell from 55% of GDP during 1998-2002 to just below 16% by 2007 while aggregate reserves rose almost eight-fold from \$95 billion to \$726 billion (IMF 2008, 61). Even capital-deficient Algeria saved half its oil revenue over 2000-07. However, from 2005 public expenditure began accelerating and MENA import volumes grew faster than exports so that external surpluses began shrinking, dropping from 21% of GRP to 17% 2006-07, and Dutch disease effects intensified in all three types of economy (World Bank 2011c).

Overall, MENA oil-exporters saved just over two-thirds of the additional oil revenue 2004-07, but this ratio reflected the high relative weighting of the capital-surplus oil-exporters within the group. Sovereign wealth funds (SWFs) played a critical role in sterilising the 1999-2009 oil windfalls, growing in size to range from \$875 billion in the UAE through \$300 billion in Saudi Arabia and \$250 billion in Kuwait to \$8.2 billion in Oman (Deutsche Bank 2008, 3). But a significant fraction of the current account surpluses, perhaps two-fifths and almost all of it from four GCC economies appears to have leaked via unrecorded capital flight into offshore personal bank accounts (Pfieffer 2011). Whereas the capital-surplus economies cushioned themselves against price shocks, the capital-deficient oil-exporters, most notably Iran, increased their spending through the late-2000s and therefore their vulnerability to negative price shocks. The IMF projected that sustained high oil prices would lift the total assets of the MENA oil-exporters from around \$2-3 trillion in the late-2000s, of which the GCC held half<sup>5</sup>, to \$6-10 trillion by around 2014.

The high rate of saving did not stop MENA government expenditure from rising during the boom, typically by over half. Initially, the increase went mainly on salaries and subsidies to compensate rent recipients for real falls in welfare since the early-1980s. Governments continued to under-price energy on domestic markets, which deterred energy efficiency and accelerated hydrocarbon depletion: Saudi Arabia is predicted to cease oil exports before

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<sup>4</sup> The IMF figures include Syria as well as Azerbaijan, Kazakhstan and Uzbekistan, which together comprise less than one-tenth of the total.

<sup>5</sup> Net foreign assets were \$850 billion in the UAE (450% of GDP), \$515 billion in Saudi Arabia (130% of GDP), \$285 billion in Kuwait (215% of GDP), \$85 billion in Qatar (130% of GDP) and around \$10 billion in Oman \$10 (35% of GDP). Beyond the Gulf region, Libya had \$40 billion in overseas investment and Iran had \$9 billion.

2030 under current policies (Mitchell and Stevens 2008). Data are not available for Bahrain, Iraq, Oman and Sudan but of the remaining seven MENA oil-exporting economies, three (Iran, Qatar and Algeria) saved less than half the increased revenue. Iran was unique in spending slightly more than the increase in its revenue. Capital-surplus Qatar, which rapidly expanded natural gas production, recorded the next highest ratio of windfall spending to total revenue at just over 70% while Algeria was third highest at 58%. The four remaining economies were all capital-surplus economies and expended less than half the extra revenue: Saudi Arabia and Libya each expended around 45%, Kuwait 25% and the UAE 20%<sup>6</sup>.

Public investment rose as well as public consumption, but after an initial lag. By 2007, gross fixed investment reached 48% of GDP for the MENA oil-exporters compared with 35% in 2003. But the returns to infrastructure investment in the MENA region lag other developing regions. Um et al. (2009) find that although energy and telecommunications investment are associated with higher total factor productivity the gains are inferior to those of other regions. They attribute this to lags in institutional and policy reforms that undermine investment efficiency. Um et al (2009, Tables 1 and 2 on pages 2-3) cite disappointing levels of service effectiveness, despite the region's relatively high investment effort.

Contrary to rent cycling theory, the rate of PCGDP growth of the labour-surplus economies through the 1999-2009 boom under-performed in comparison with both MENA oil-exporters and reformed economies in the Asia Pacific region (Table 4). Yet most labour-surplus economies had been pursuing reforms since the early-1990s that included trade liberalisation, privatization and prudent macro policies. The explanation lies in the constraints placed on reforms by the elite, once it had secured the more economically attractive privatizations so that the maintenance of regulatory rent assumed priority.

In common with the oil-exporting economies, employment failed to expand fast enough to absorb surplus labour, leading to high levels of unemployment especially among the young, while those with jobs were well-protected from dismissal and the elite continued to accumulate wealth. Income disparities widened and contributed to the civil unrest first in the labour-surplus republics of Tunisia and Egypt in 2011 and then Yemen and Syria, whereas the monarchies of Jordan and Morocco remained relatively stable. Some capital-surplus oil-exporters like Saudi Arabia<sup>7</sup> and the UAE felt impelled to sharply expand social entitlements. Libya responded too late. Saudi Arabia abruptly raised public expenditure during 2011, which Askari (2012,183) wryly predicts will trigger Dutch Disease effects and intensify demand for subsidies.

Like Russia, the MENA economies suffer from rent addiction (Gaddy and Ickes 2010), a much more difficult condition to treat than rent-dependence. By 2008, MENA oil exporters regarded \$80 per barrel as a 'realistic' price for oil, i.e. the oil price required to balance the public finances. Among the capital-deficient oil-exporters the oil price required to balance the budget of Iraq and Bahrain was just over \$100 per barrel, \$95 for Algeria and \$85 for Iran. But by 2010 Saudi Arabia and the UAE had drifted up to public expenditure levels requiring \$80 per barrel compared with \$73 for Oman, \$48 for Kuwait and \$39 for Qatar. Conditions then deteriorated quickly in 2011: by sharply increasing public expenditure in response to the 'Arab Spring', capital-surplus Saudi Arabia required prices of \$100 per barrel (Financial Times 2012). The price required in 2002 had been below \$25 (IMF 2011b).

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<sup>6</sup> In current dollars the public expenditure per capita in 2007 ranged downwards from \$20,000 for Qatar, through \$9,000 for Kuwait and the UAE, \$4,900 for Saudi Arabia, followed by Libya with \$3,800 and finally capital-deficient Iran (\$2,300) and Algeria (\$1,300).

<sup>7</sup> World Bank (2011b, 29) estimates Saudi Arabia boosted public spending by 25% of GDP in 2011

## 5. Conclusions

This paper offers a new comparative perspective on how natural resources shape paths of economic and political development. It reviews the literature to argue that the oil curse as a variant of a broader rent curse whose symptoms can be replicated in varying degrees not only by natural resources but also by geopolitical rent, regulatory rent and labour rent. The oil curse is an intense form of the rent curse due to the unusually capital-intensive nature of oil extraction, which favours large-scale production so the rent is large relative to GDP and concentrated on a handful of economic agents, notably the government. According to the theory of rent cycling these two properties carry high risk of igniting elite contests for rent that undermine long-term economic growth and political maturation.

Rent cycling theory posits that differences in the scale and distribution of rent systematically impact the elite incentives that determine the development strategy that drives the trajectory of the political economy. Basically, low rent incentivises the elite to grow the economy in order to expand their income and also taxes (the elite tend to benefit disproportionately from tax expenditure). These incentives require policies to maximise investment efficiency, which in low-rent economies encourages specialisation in labour-intensive manufactured exports that drive rapid structural change and proliferate social groups able to contest political power and limit scope for policy capture by any single group.

In contrast, high rent triggers elite contests to extract rent for immediate and personal gain. Rent is therefore channelled into patronage for political ends at the expense of economic goals. Domestic rent absorption proceeds too rapidly and triggers Dutch disease effects that governments counter by expanding employment that markets would not support in protected industry and over-expanded bureaucracy. The economy's rising dependence on rent-generated subsidies distorts it; lowers investment efficiency; and causes growth to collapse when demand for subsidies outstrips supply. Growth collapses are protracted because rent recipients resist economic reform because it shrinks scope to extract rent.

The application of rent cycling theory to MENA economic development through the 1973-82 and 1999-2009 oil booms identifies the emergence of a distinct and brittle regional political economy characterised by persistent rent-dependence (arguably rent addiction), patrimonial capitalism, acutely distorted labour markets and autocratic governance. The capital-surplus oil-exporting economies are the most distorted because their huge rents accommodate patronage cycling for longer and on a greater scale whereas capital-deficient oil exporters struggle to balance their budgets.

The failure of the labour-surplus economies to complete basic reforms appears contrary to rent cycling theory and the resource curse. It is not, however, but rather reflects the fact that the labour-surplus economies generated sufficient rent in aggregate from hydrocarbons, labour remittances, foreign aid and government regulation to incentivise elites to prioritise rent-seeking over growth. The labour-surplus economies have been less distorted because their smaller rents had lower tolerance for politically-driven policies. Nevertheless, all three types of economy became addicted to oil rent by the 2000s, whether directly cycled or indirectly cycled, and neglected in varying degrees the opportunity the windfalls conferred to reform towards productivity-driven growth. Rent cycling theory

suggests improved development outcomes require the sterilization of rent in funds from which it is dispersed, after Segal (2011) on a per capita basis across many economic agents<sup>8</sup>.

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<sup>8</sup> Iran plans to transfer \$50 billion annually (almost 60hd/month) while withdrawing inefficient fuel subsidies.

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**Table 1 Stylised rent stream properties and predicted political economy Impacts, by rent source<sup>1</sup>**

	Concentrated natural resource rent	Diffuse natural resource rent	Regulatory rent	Remittances (labour rent)	Foreign aid (Geopolitical rent)
<b>Rent stream properties</b>					
Scale (% GDP)	8-20+	5-15	5-20+	2-10	2-10+
Degree of rent concentration	High	Low	High	Low	High
Volatility (Standard Deviation)	High	Moderate	Moderate	Moderate	Low
<b>Potential rent impacts: economic</b>					
Dutch Disease effects	High	High	Moderate	Moderate	High
Market repression and corruption	High	Low	High	Low	Equivocal
Investment efficiency	Declining	High	Low	High	Equivocal
GDP growth	Decelerating	Rapid	Decelerating	Moderate	Equivocal
<b>Potential rent impacts: political</b>					
Self-reliant social capital	Low	High	Low	Moderate	Equivocal
Proliferation of social groups	Constrained	High	Constrained	High	Equivocal

Note: 1. Most economies generate more than one rent stream

**Table 2 Share of hydrocarbon rent in MENA economies 1970-2009 (% GDP)**

	1970-74	1975-79	1980-84	1985-89	1990-94	1995-99	2000-04	2005-09
<b>Capital-Surplus</b>								
Iraq	30.2	57.6	37.5	37.5	n.a.	n.a.	n.a.	60.0
Kuwait	69.1	67.7	48.9	31.0	29.2	35.8	46.5	34.6
Libya	29.3	50.8	46.5	26.9	n.a.	n.a.	56.0	38.0
Qatar	71.5	73.9	60.2	35.1	39.1	n.a.	n.a.	n.a.
Saudi Arabia	52.3	63.1	54.3	29.0	39.4	32.5	44.7	36.4
UAE	n.a.	62.6	50.3	30.7	36.0	26.8	30.1	n.a.
<b>Capital-Deficient</b>								
Algeria	14.2	28.7	31.2	14.9	22.7	25.7	37.8	25.8
Bahrain	n.a.	n.a.	67.3	39.5	31.1	22.0	27.8	26.7
Iran	27.4	38.4	18.3	9.7	n.a.	21.2	32.6	27.8
Oman	48.8	63.6	54.7	39.4	36.8	33.0	50.3	37.6
<b>Labour-Surplus</b>								
Egypt	1.7	11.2	23.6	11.0	10.3	5.2	7.1	13.2
Jordan	0.0	0.0	0.0	0.3	0.2	0.2	0.2	0.2
Morocco	0.3	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Sudan	0.0	0.0	0.0	0.0	0.1	0.9	14.5	14.3
Syria	3.8	12.2	13.0	11.3	22.8	21.5	21.4	17.9
Tunisia	2.5	6.3	9.7	4.2	3.2	2.2	2.8	4.9
Yemen	0.0	0.0	0.0	n.a.	18.1	24.6	26.5	24.6

Source: World Bank (2011a).



**Table 3 Foreign aid and remittances, MENA labour-surplus economies 1970-2009**

	1970-74	1975-79	1980-84	1985-89	1990-94	1995-99	2000-04	2005-09
Foreign aid (% GNI)								
Egypt	5.4	15.4	6.0	4.7	9.1	2.6	1.4	0.8
Jordan	15.1	26.4	20.1	8.7	13.7	6.7	6.8	3.6
Morocco	2.1	3.3	4.5	3.0	3.5	1.6	1.2	1.4
Sudan	1.7	5.2	8.3	6.3	7.4	2.5	3.1	5.5
Syria	4.6	10.2	4.5	3.6	3.9	1.7	0.6	0.3
Tunisia	5.9	4.5	2.6	2.8	2.2	0.8	1.4	1.1
Yemen <sup>1</sup>	n.a.	n.a.	n.a.	n.a.	6.2	5.5	3.7	1.5
Remittances ( GDP)								
Egypt	n.a.	10.1	11.3	8.9	11.0	4.5	3.4	5.1
Jordan	4.5	19.8	22.3	16.7	15.0	22.6	21.7	17.7
Morocco <sup>2</sup>	3.1	5.7	6.2	7.2	7.2	5.5	7.3	7.9
Sudan	n.a.	1.0	3.0	1.5	0.9	4.2	6.1	4.3
Syria	n.a.	5.7	3.0	3.0	3.6	1.9	1.9	2.7
Tunisia	n.a.	3.5	4.1	4.2	3.8	3.7	4.8	4.9
Yemen <sup>3</sup>	<i>31.4</i>	<i>58.1</i>	<i>21.2</i>	<i>n.a</i>	23.5	19.5	12.3	6.2

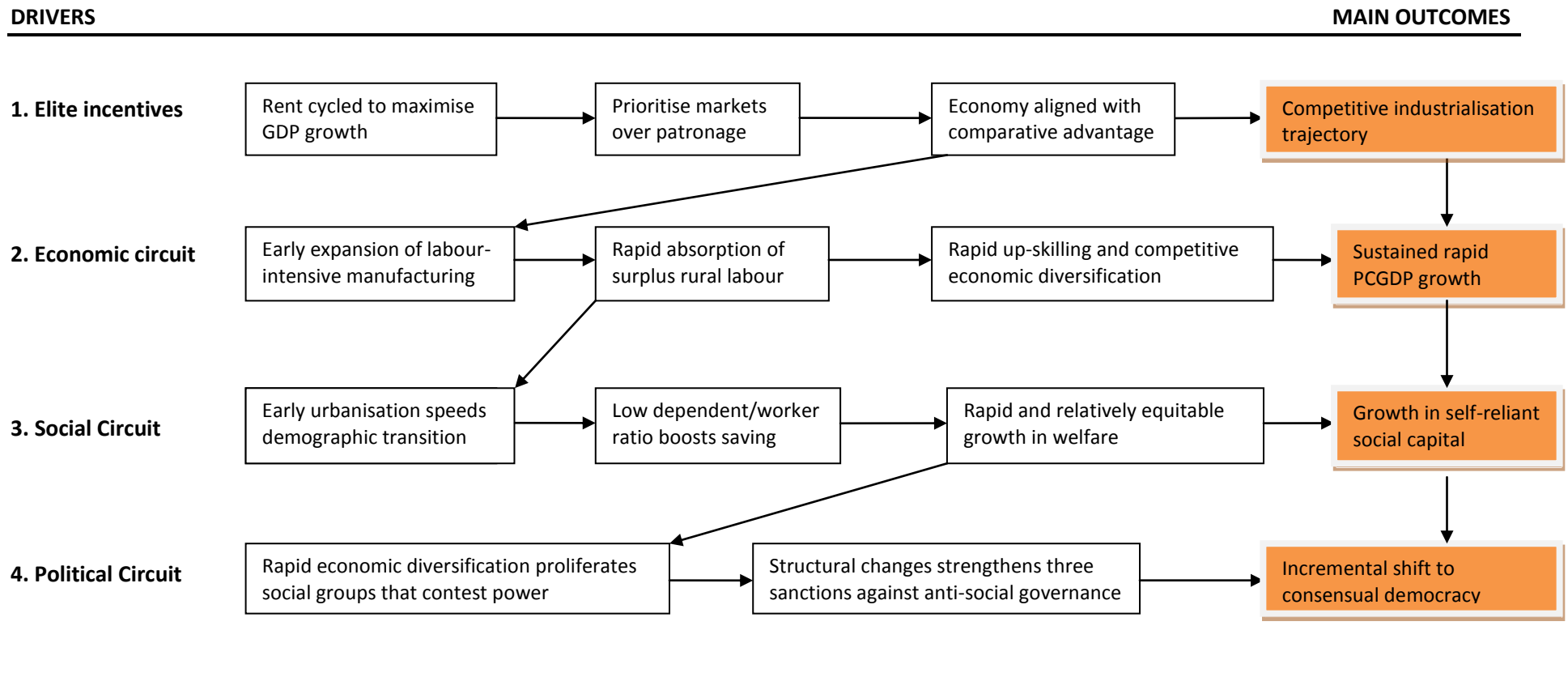
Source: World Bank (2011a). 1. Consistent time series data for Yemen commence with political unification in 1990. The italics show data for north Yemen only 1970-87 from World Bank (1989). 2. Data for 1970-74 from World Bank (1989). 3. Sources suggest Yemeni foreign aid rose to around 6% of GDP through the 1973-82 oil boom and remained there until the 2000s.

**Table 4 Per capita GDP growth, MENA and other developing regions, 1961-2008**

	1961-70	1971-80	1981-90	1991-2000	2001-08
Middle East and North Africa	3.9	3.0	-1.3	1.1	2.7
MENA oil exporting economies	5.8	-0.2	-1.6	-5.9	3.4
MENA labour-surplus economies	2.0	3.2	-1.0	7.0	2.0
East Asia and Pacific	4.3	3.6	2.5	6.4	8.0
Latin America and Caribbean	2.7	2.3	0.5	1.7	1.5
Sub-Saharan Africa	1.8	1.6	0.2	-0.4	2.5
South Asia	2.0	0.7	3.2	2.7	5.4
World	3.1	2.5	1.0	1.3	1.7

Source: World Bank (2011a).

**FIGURE 1 LOW RENT COMPETITIVE INDUSTRIALIZATION DEVELOPMENT TRAJECTORY: VIRTUOUS SOCIO-ECONOMIC CIRCLES**



**FIGURE 2 HIGH RENT STAPLE TRAP DEVELOPMENT TRAJECTORY: PROTRACTED GROWTH COLLAPSE**

