Weak and Marginalized Social and Legal Institutions: An explanation of the irony of poverty and economic underperformance in resource-rich countries

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Introduction
In the book, “The Paradox of Plenty,” Terry Lynn Karl sought to solve the perplexing puzzle of why countries that experienced unprecedented transfer of wealth from the oil booms of the 1970s and 1980s, without exception, displayed similar economic development outcomes in spite of having very dissimilar histories, geo-strategic importance, and socio-political arrangements. The book, while a remarkable effort, managed to confirm what the literature on the subject had been alluding to but failed to give coherence -- reliance on a dominant natural resource to drive macroeconomic development would, with recent minor exceptions, always and everywhere engender bureaucratic corruption, rent-seeking behavior, authoritarian or quasi-democratic political structures, and disincentives to develop other internal sources for economic growth. Where all these are present, the country cannot help but remain economically underdeveloped. That this is the common experience of most oil exporting countries, despite their differences in every other respect, is logically and empirically consistent -- an economic imperative, as it were. A different outcome would have been an anomaly.

What I intend to achieve in this paper is to show that, in addition to known culprits, the observed similar economic outcomes in most oil exporting countries is primarily the result of weak or nonexistent domestic social institutions, and damaging interferences by international financial institutions, and a world trade order based on neoclassical orthodoxy. While reliance on a natural resource as means to sustainable development is not inherently a bad economic policy, it nonetheless fosters harmful incentives amongst the country’s elites that are debilitating to the economy; and when compounded by policy prescriptions from outsiders (IMF, World Bank, WTO), the cocktail effect is the observed commonality of economic underdevelopment. A comparative study of four oil-exporting countries – Indonesia, Algeria, Iran, and Venezuela, would be used to show how each country manifested the effects of oil revenue, and how their respective economies suffered as a result. Nigeria, as a special case of this phenomenon, would be addressed in chapter IV.

Similarities and outcomes
A generalizable observation from past empirical studies is that states that derive budget-
sustaining revenues from the same source tend to have similar ability and capacity to implement development projects. How and where a state derives its revenue, and to what uses it puts them matters; thus if a state depends almost exclusively on its extractive sector, agriculture, foreign aid, and loans to discharge its public obligations, and commitments on development projects, its nature and capacity would differ from one that derives its revenue from a broad-based taxation of goods and services. In the latter, there would be significant state capacity, transparency and accountability to tax payers; the opposite is the case in the first instance. This is because in the absence of significant build-up of essential social institutions that provide requisite checks and guidance, an unexpected influx of revenue into the state engenders counter-productive incentives, and distorts public policy choices. Unsurprisingly, states with similar sources of revenue tend to experience similar economic performances, albeit with minor exceptions. The four countries presented in this chapter (Algeria, Iran, Venezuela, and Indonesia) are properly categorized as rentier states; a category that encompasses petro-states, and other natural resource-dependent states. These states by virtue of their source of revenue, depend less on domestic taxes to finance government activities (hence unaccountable to the citizenry), are inclined to remarkable centralization of power, and almost invariably have compromised capacity.

The oil-boom that began with price increases in 1973 led to unanticipated windfalls for OPEC countries. By 1974, oil prices had quadrupled, and without exception, policy-makers in all four countries under consideration saw this as an opportunity to place their respective countries on a path to resource-led development. The immediate impact of the oil boom in these countries was an incredible increase in national income; in Iran, and Indonesia national savings as a fraction of GDP almost doubled in a span of six years. For Venezuela and Algeria, the impact on national income was just as impressive, and their collective reaction was expectedly similar: government spending rose in tandem with higher demand for public services, infrastructure development, and subsidies for agriculture and housing. Between 1973 and 1974, Iran’s expenditure on industrial programs rose by 58.5%; for Venezuela, the rise in expenditure was 74.5%. This remarkable increase in public spending was financed by a combination of realized petrodollars, and borrowing from international lenders. Gelb (1984) estimated that about
half of the windfall derived from the first oil boom was spent on infrastructure development, a quarter went to offset a growing trade-deficit, and a quarter went to sustain domestic consumption. For Algeria, the expenditure on infrastructure development had exceeded 74% of GDP by 1977; in the same period, Iran, and Venezuela had doubled the ratio of investment to their respective Gross Domestic Products.

As the oil windfall continued into the mid 1970s, these oil-exporting countries also spent more on their non-oil sectors, which grew by a collective average of over 12% between 1974 and 1976. This enhanced employment in the public sector, and spending on infrastructure development sustained a broad-based subsidy of consumer goods and services deemed essential. Thus between 1970 and 1979, private consumption in these countries increased by an average of 7 percent. In Algeria, for instance, education and petrol were subsidized, in part to benefit the poor, but in the main, as means to benefit ruling political and business elites. But by 1983, as the second oil-boom came and went, these countries, now accustomed to unrestrained public spending, saw public spending surpass revenue as world-wide demand for oil dropped, and oil prices fell. This dramatic turn of events was compounded by the reality that once a given level of expenditure is built into the system, there is often a lack of political will to retrench when revenue declines; capital flights, high levels of inflation, public sector inefficiencies, and bloated domestic currencies made matters worse. There were also political fall-outs from this: the autocratic regime in Iran fell with the ouster of the Shah in 1979, Algeria came close to a civil war as the government became increasingly unable to meet its public obligations, and Venezuela’s democratic system of governance almost collapsed.

With the cartelization of OPEC, and the two oil booms in the 1970s and 1980, the consensus in certain quarters of the international lending community was that OPEC countries were credit worthy. On this assumption, they eagerly lent to oil exporting countries; thus between 1976 and 1982, Venezuela and Algeria saw their respective foreign debt rise by more than 45% per year. And about the same period, Algeria, Venezuela, and Iran accounted for almost half of all loans extended to the Less Developed Countries (LCD) between 1976 and 1979. By 1980, the least developed oil exporting countries had a
combined total foreign debt of over $100 billion, up from a low of $19.5 billion in 1973; by 1984, this amount had topped $280 billion with a debt service of over $44.6 billion (Figures derived from enclosed tables, and the World Bank.). The consequences of this debt burden were crippling; and by the late 1970s, all oil-exporting members of OPEC faced double-digit inflation, production bottlenecks, bureaucratic inefficiencies in the public sector, and dependence on petrodollars was almost complete. In Venezuela, and Algeria, agriculture, and manufacturing sectors were essentially abandoned, while the consumption of non-tradable goods and services rose dramatically (by almost 60% in Algeria, and Indonesia). In all four oil exporting countries between 1973 and 1980, the share of the oil industry in the economy rose significantly as agriculture declined.

By the late 1970s, the data show that these countries were running very high budget deficits that soon produced massive current-account shortages as imports rose, and domestic production fell. The ensuing appreciation in the real exchange rates encouraged more imports, and set the trend for import-dependency that continued long after the oil boom; it also made domestic products uncompetitive, and thus led to its neglect and disuse. Between 1974 and 1978, the least developed oil-exporting members of OPEC went from a current account surplus of over $25 billion to a combined current account deficit of more than $15 billion (World Bank, 1980); by 1975, their annualized rate of import stood at 67%, and by 1983, their average exchange rate was more than 39% (Gelb, 1984). But with the entrance of new oil exporters such as Norway, Great Britain, OPEC countries share of world oil production fell from 54% to 32% in 1973, and price per barrel of oil dropped to $13 in 1986 from $32 in 1981. The combined effect worsened an already deteriorating economic conditions in Iran, Algeria, and Venezuela, --- declining wages, rising unemployment, capital flight, and inflationary pressure, and demand for repayment of loans by international lenders. This was especially the case in Venezuela that experienced a drop of 65% in oil revenue between 1980 and 1986, and a ratio of debt to GDP of over 60%; Indonesia fared worse with a decline of 76% in revenue in the same period. By 1988 the vast majority of OPEC countries had a ratio of debt service and export of more than 38 percent.
A common beginning with identical response to sudden wealth
Policy makers in Venezuela, Algeria, Iran, and, to a lesser extent, Indonesia, when faced with unexpected windfall from oil increased public spending; they also increased the level of borrowing to finance their respective models of resource-led development. But invariably, their attempts at development led to declining agricultural and manufacturing that meant more reliance on imports than on domestic production of both tradables and non-tradables. The influx of petrodollars remarkably overvalued their respective currencies, and led to the decline of non-oil sector production. The overall decline in each country’s Gross Domestic Product as a result made it impossible to realize their development goals. But while this outcome was common amongst these countries, each followed a different development model: Algeria favored a heavy-industry led development; Venezuela paid emphasis on steel and aluminum industries, and invested heavily on primary and secondary education; Indonesia concentrated on the development of its natural gas sector, while Iran devoted a great deal on its defense industry.

While these oil-exporting countries responses to sudden wealth are similar, they also share similar historical experiences and transformations as nation-states: all constituent oil-exporting countries of OPEC were weak states, in the sense of institutional capacities, prior to the first oil boom of 1973. International oil companies that prospected for oil, drilled for it, and produced it in these countries took advantage of the weak institutional capacities they encountered, and almost without exception, shaped the nature of the state, and led to the near exclusive reliance on corporate taxes on oil companies as source for state revenue. In Iran, Algeria, and Venezuela, these historical realities informed, to a great extent, their response to the boom effect of oil; in all of these countries, the government’s response led to expansion of its economic and political influence in the country, and encouraged rent-seeking activities that hastened the deterioration of the economy. Already weak state capacities were further weakened. Terry Karl (1997), explains:

“None of these countries possessed administrative structures capable of creatively resisting the process of petrolization. Instead their states were easily penetrated by foreign companies. Executive power became linked to the fate of the oil industry, and states centralized while expanding their jurisdiction in an oil-propelled dynamic....without exception, diffusion accounted for the fact that newer producers adopted the same tax arrangements developed originally by Venezuela; and their states were quickly characterized by the same fundamental economic policy pattern: maximizing the extraction
of oil rents for subsequent domestic distribution through public spending according to a political logic.”

Each of these countries came to resemble each other in their use of high corporate income taxes on oil companies, and low or non-existent taxes on goods and services in non-oil sectors. As dependence on oil revenue increased, Indonesia, Venezuela, Algeria, and Iran were collecting an average of 4.6% of total revenue from taxes on goods and services by 1975; in comparison, non-oil exporting countries were averaging 40% from similar sectors in the same period (Gelb, 1984). For Venezuela, the dependence was remarkably striking; by 1975 it was getting about the same percentage of its GDP from taxes as its non-oil exporting counterparts of similar capacity but almost all of Nigeria’s tax revenue came from the oil sector, and still does.

**Country-specific experiences:**

**On Iran**

Iran, in similar fashion with Venezuela, reached an agreement with international oil companies on a fifty-fifty revenue sharing scheme. The immense benefit from this arrangement enabled the government of the Shah of Iran to sustain the loyalty of the minor political support his regime enjoyed but spent more to suppress internal opposition. This process inevitably led to rent-seeking activities that distorted state economic priorities with less attention given to domestic productivity (Halliday, 1971). As the state became increasingly reliant on revenue from oil and less on domestic taxation, the business and political elites became dependent on it for income and privileged access to lucrative contracts that fueled the drive to adopt Western-style capitalism, modernization through investment in heavy industries, and a build-up of military capacity (Katouzian, 1981). Modern Iran is governed on the bases of a constitution that stemmed from the 1979 revolution, and fashioned on a complex mixture of republican-democratic principles and Islamic legal doctrines. Within this innovative arrangement is the concept of supreme jurisprudence that provides for an unelected supreme leader to govern the affairs of the state, thus suppressing an important principle of democracy at the national level, but restores this principle by allowing direct election of governmental entities that include the president, members of parliament, and local governing bodies. Article 110 of the constitution gives the current supreme leader, Ayatollah Ali Khamenei, the exclusive power
to appoint heads of powerful social institutions such as the commander of the armed forces, and the commander-n-chief of the Islamic Revolutionary Guard; but more importantly, all constitutional reforms can only occur with the approval of the supreme leader. Such centralization of power has been a source of tension among reformists that seek further decentralization at the national level, and a weakening of bureaucratic inhibitions to full market oriented capitalism.

The modern constitution and the establishment of the Islamic state was conceived out of the desire to re-align political sovereignty with divine authority, and to enable the state much needed flexibility to protect and care for the needy. This lead to a plan to centralize the management of economic activities at the national level that would send directives to the local level; it also called for the nationalization of the banking system and the establishment of charitable institutions to invest and distribute funds set aside for the welfare of the poor. Unfortunately, and as to be expected, the lack of adequate oversight of these charitable institutions has led to wasteful bureaucratic excesses, and corruption.

Iran's economy is heavily dependent on revenues from oil; and as of 2010, oil revenues account for 60% of the country's budget, and 85% of its export revenue. Since the state is the direct recipient of revenues from oil sales, it necessarily dominates the country's economy. Quai-state bodies, such as the Bonyads, which run state-subsidized charitable institutions under the directive of the supreme leader, are also important actors in the economy with a workforce of over 210,000 personnel. The World Bank (2010) estimates that the public sector controls over 80% of the economy, while the private sector, which dominates small industries and limited domestic and foreign trade, accounts for the remaining 20%. Key economic indicators from 2009 to 2010 show that 15 million Iranians or 20% of the country's population live in poverty despite the existence of state-subsidized charitable institutions designed to alleviate poverty. The same indicators show a continuous weakening of overall development, which has in turn restrained the choices available to the citizenry even though in 2010 the UNDP ranked Iran 70th out of 169 countries in its Human development Index. This ranking, however, masks the low growth rate of 1.1% in 2009, and 1.6% in 2010 (IMF, 2011); the consequences of these figures are
dire, and are a direct result of bureaucratic corruption, and social exclusion of scores of university lecturers, religious minorities and students believed to be active in activities not conducive to state’s stated objectives.

The current government’s stated top priority since assuming power in 2005 is the transformation of the economy to a welfare society that would bring "oil revenues to the people’s dinner tables, and to prioritize economic development over political and cultural development." A combination of factors, including international sanctions, has made this priority a hope yet to be realized. In fact, more than six years into the regime’s tenure, the country’s economy has performed worse, and has been on a path on continuous decline. The economic policy of targeted subsidy or better known as "The Subsidy Reform Plan" has been a source of national controversy and disputation since its implementation in October, 2010. Informed officials within the government now believe that this policy is the primary source of heightened inflation and weak economic performance, and should, at the least, modified. The supreme leader, of course, disagrees.

Iran’s Statistical Profile in 2010

Population: 74.2 million
Adult literacy: 82.3%
Fertility rate: 1.8
Human development index: 70.2

Economic Performance in 2010

Gross Domestic Product (GDP): IR 3,265 trillion ($331 billion)
GDP per head: $4,540
Av. Ann. Growth in real GDP 2004-09: 3.8%

Sources of GDP:
Agriculture: 10%
Industry: 44%
   Of which:
     Manufacturing: 11%
Services: 45%

Components of GDP:
Private consumption: 45%
Public consumption: 11%
Investment: 33%
Exports: 32%
Imports: -22%

**Trade:**

**Principal exports:**
- Oil and gas: $86.6 billion
- Industrial goods: $10.8 billion
- Agricultural goods: $3.3 billion
- Metallic mineral ores: $0.3 billion

Total: $101.3 billion

**Principal Imports:**
- Machinery and transport equipment: $19.2 billion
- Iron and steel: $9.3 billion
- Food items: $6.4 billion
- Chemicals: $6.3 billion
- Mineral and fuel: $4.7 billion

**Total Imports:** $56 billion


While the government encouraged high consumerism through subsidies, and privileged access to appease the educated class, it systematically dismantled traditional nomadic agriculture, and spent more to develop a police state suitable for oppressive activities. However, after years of neglect and institutional atrophy, the leveling-off of oil process in 1975 began to expose weaknesses in the economy and the regime’s inability to manage the consequences of systemic misalignment of revenue with expenditure. With petrodollars in short supply, the oil-based economy began to contract; the oil-based regime, however, was overthrown. Iran, like other petro-states, exhibited a pattern of political instability, unsustainable economic realities, and institutional weakness common to oil-led development. The fact that the British, Russians, Turks, and Americans intervened in Iran’s domestic affairs with the discovery of oil at the time it was in the process of instituting a modern state decidedly compromised its state capacity.
## IRAN COUNTRY REPORT

### Economic Indicators

<table>
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<th></th>
<th>2007</th>
<th>2008</th>
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<td>Inflation (CPI) %</td>
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<td>Unemployment %</td>
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<td>Export Growth %</td>
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<td>Tax Revenue % of GDP</td>
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<td>Military expenditure % of GDP</td>
<td>2.5</td>
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### On Venezuela

A state of administrative weakness, turmoil, and bureaucratic chaos defined the state of affairs in Venezuela when foreign petroleum companies arrived in the early 1900s. But until the oil boom of 1973, the semblance of a modern state was nonexistent; the oil boom provided the means and will to develop institutional state apparatus capable of placing the country on track towards economic development, anchored on the beneficent attributes of industrialization. With this first oil boom, the country realized over $10 billion of unconstrained funds to serve the social and economic needs of a population slightly over
12 million people. The newly elected president, Carlos Andres Perez, saw a future of limitless possibilities; and embarked on massive social, and infrastructure development projects. But while the huge influx of petrodollars was recent, Venezuela had long being a petro-state before 1973; thus, the administration’s decisions, and policy choices made after 1973 were heavily shaped by past influences of petrolization. The increase in oil revenue only heightened this influence.

The rise to power of the current president, Hugo Chavez, marked the beginning of a strong preference for a collectivist society, even though the vast majority of the population oppose such directional shift. This is in contrast to the social experiment of the later half of the 20th century when Venezuela was looked upon as a model of democracy in Latin America. In the 1960s and 1970s, the country made strong gains in the political sphere as it progressively liberalized its electoral process, giving more rights to minority political parties, and encouraged proportional representation. But the economic and political elite, beginning in the late 1980s began to undermine this process as they saw their privileged positions begin to erode. The result was a political crises, and a retrenchment of the country’s party democracy in the 1990s; this ultimately encouraged a populist movement and the rise of the ‘Caudillo.’ The ground was set for the quasi-democratic apparatus now in evidence, and an actual authoritarianism that defines the country’s governance structure.

Like all other newly independent oil-exporting countries, the formation of state capacity and essential social institutions coincided with the stage of dominance of oil as the primary source of revenue. The use of oil windfall allowed the consolidation of executive power, and enabled the expansion of the state’s jurisdictional competence into the further reaches of society. With this expansion came the inevitable consequence of abandoning domestic sources for revenue to sustain fiscal expenditure, thus freeing policy makers from accountability, and transparency in the fiscal affairs of the state. With the absence of an independent judiciary, a semi-autonomous central bank, and a relatively corruption free bureaucratic machinery, the conditions in Venezuela were ripe for the failures that accompany a resource-led development effort – rent-seeking activities, a bloated,
inefficient and corrupt public sector, and the marginalization of non-oil sectors. Karl (1997) made this observation:

“The shift to an oil economy had predictable Dutch Disease effects, delaying industrialization, and exacerbating the decline of agriculture. Because an oil-mediated integration into the world market provided sufficient revenues for a continuous expansion of the country’s low import capacity, incentives for other productive activities barely developed. The bias against productive links was further exacerbated by exchange-rate movements related to petroleum. Because oil caused the appreciation of the bolivar in relation to the dollar, it further encouraged imports and discouraged domestic activities.”

By the 1980s and 1990s, the effects of mismanagement of the oil windfall became very real – huge external debt, debilitating debt-service ratio to GDP, deteriorating agricultural sector, and dependence on imports for manufactures. The political life of the country did not escape this harsh reality; the oldest democracy in Latin America is now governed by the autocratic regime of Hugo Chavez with pretenses to democratic rule.

**Venezuela's statistical profile in 2010**

Population: 28.6 million  
Adult literacy: 95.2%  
Fertility rate: 2.6  
Urban population: 93.4%  
Human Development Index: 69.6

**Economic performance in 2010**

Gross Domestic Product: Bs700 billion ($326 billion)  
Per capita GDP: $11,490  
Economic freedom index: 37.6

**Origins of GDP**

Agriculture: 4%  
Industry, of which: 37%  
Manufacturing: N/A  
Services: 59%

**Components of GDP**

Private consumption: 64%  
Public consumption: 13%  
Investment: 25%  
Exports: 18%  
Imports: -20%

**Structure of employment**
Agriculture: 9%
Industry: 23%
Services: 68%

**Inflation and finance**
Consumer price inflation: 29.1%
Av. Annual inflation (2005-10): 24.1%

**Trade**
**Principal Exports**
Oil: $54.2 billion
Non-oil: $3.4 billion

Total: $57.6

**Principal Imports**
Intermediate goods: $21.6 billion
Capital goods: $10.0 billion
Consumer goods: $9.2 billion

Total: $40.9


Typical of other OPEC member nations, Venezuela’s economic, social and political transformation was fueled by oil revenues. It accounts for one-fourth of the country’s GDP, more than 50% of the central government’s budget, and 90% of its export earnings; in less than a generation, its oil wealth took it from the bottom to one of the richest countries in Latin America. But between 2009 and 2011, it became clear from relevant data that the current government’s drive towards socialism, and the consequences of the state’s major role in the domestic economy was having serious negative effects on productivity, and free enterprise. Gains made in the 1970s in poverty alleviation are almost lost due to the country’s poor economic performance, and high levels of inflation. As the government accelerated its nationalization of essential sectors such as farms, industries and banks, economic productivity fell. In an effort to reverse this downward trend, the government imposed an exchange rate control in 2003, devalued its currency in January 2010, removed preferential tariffs on imported medicine and food items, and set up an oversight governmental body to regulate costs of production and profit margins.
The growth of the public sector translated to a reduced role for private enterprises in the domestic economy; thus as state enterprises became bigger, smaller private businesses found it increasingly difficult to bid for government contracts as the state enterprises took over production and supply of inputs needed for all sorts of production, e.g. steel, cement, and materials. The restriction on free international trade placed immense burden on manufacturing and the agricultural sector as the government set multiple exchange rates for different products. Venezuela is now increasingly dependent on imported food, and is the only country in the region, beside Haiti, to experience a negative economic growth in 2010. The receipt of higher prices for its oil export in 2009 notwithstanding, its economy shrank 3.3% that year, and declined by 1.9% in 2010. (World Bank, 2011).

<table>
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<th>2008</th>
<th>2009</th>
<th>2010</th>
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<td>5.8</td>
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<td>R&amp;D expenditure % of GDP</td>
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<tr>
<td>Military expenditure % of GDP</td>
<td>1.3</td>
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</table>
Algeria’s independence from France occurred within close proximity in time with the exploitation of oil as means of revenue for the newly created state. After eight years of revolutionary war, the country’s infrastructure were in shambles, and from 1962, the effort to re-build the nation, with the help of the French, was begun with earnest. The French government, for its commitment to nation-building, obtained a lower tax rate for French oil companies – a rate much lower than the 51% other oil-exporting countries were getting from foreign oil companies. By 1965, Algeria had become fully dependent on oil revenue for its fiscal objectives, and to sustain a weak and divided federal government formed on the basis of divergent interest groups.

As was the case in newly independent oil-exporting states, factions and competing interests had to be appeased, and this encouraged heavy dependence on oil revenue; by the mid 1970s, oil accounted for the majority of state funds. Algeria’s model of socialism encouraged emphasis on capital formation through industrialization, but discouraged consumerism. The 1973 boom hastened this process, and by 1976 it became heavily dependent on foreign loans to deepen the effects of its industrialization scheme in the economy (Raffinot and Jacquemot, 1977). The agricultural sector received less attention during this period of capital growth and accumulation.

**Algeria’s statistical profile in 2010**

- Population: 34.9 million
- Adult literacy: 72.6%
- Fertility rate: 2.4
- Human development Index: 67.7

**Economic performance in 2010**

- Gross Domestic Product: AD10,212 billion ($141 billion)
- GDP per capita: $4,030
- Economic freedom Index: 52.4

**Origins of GDP**

- Agriculture: 12%
- Industry, of which
  - Manufacturing: 6%
  - 55%
- Services: 34%

**Components of GDP**

- Private consumption: 41%
Public consumption: 14%
Investment: 41%
Exports: 40%
Imports: -36%

Trade
Principal Exports:
Hydrocarbons: 44.4 billions
Semi-finished goods: 0.4 billions
Raw Materials: 0.2 billions

Total incl. Others: 45.2 billions

Principal Imports:
Capital goods: 15.1 billions
Semi-finished goods: 10.3 billion
Food: 5.8 billion
Total incl. others: 39.3 billion


State expansion driven by socialist ideals meant that the private sector was largely ignored and starved of funds as the state channeled its revenue into public infrastructure development, and state-financed heavy industries. But bureaucratic corruption soon became pervasive; access to government contracts was now based, not on merit, but on friendship and familial relationships. By 1977, due to the neglect of agriculture, food shortages and rising prices led to social unrest. As agricultural output fell, the country became more dependent on imported food made possible by petrodollars. The emphasis on heavy industries as means to economic development did not meet expectations, and as oil prices fell in 1986 food imports rose by more than 30 percent; the economy was in serious decline, and by the 1990s, the economy was further threatened by rising inflationary pressure (Amair, 1992). As oil prices fell in 1986, the authoritarian, rent-sustaining government, backed by the military, suffered major setbacks as citizens took to the streets in protest of existing socioeconomic conditions. As a consequence, in 1989, a new constitution was put in place abolishing the National Liberation Front that monopolized the political and economic activities of the country in the preceding 25 years. As the country devolved into further conflict and instability in the 1990s, the country became almost ungovernable as more than 180,000 Algerians lost their lives in the ideological and
religious struggles between vested groups and interests. The 1996 presidential election that brought Liamine Zeroual into power brought relative calm, but not much in the way of political liberalization.

At the urging of the IMF in 1994, the government took tentative steps towards a market economy, and implemented various transformative reforms that created massive unemployment in the public sector. The privatization effort shed more than 400,000 public-sector jobs; the outcry from the public forced the government to scale back its experiment with market capitalism, and by 2000, stopped the privatization of state-owned industries. To create more jobs in the economy, the government embarked on massive spending on infrastructure development, and public housing, and has continued such interventions in the domestic economy ever since. Through regulatory measures, the government controls prices on a wide array of products, and subsidizes almost the same amount of essential primary items such as food and medicine. In 2009, food and product subsidies cost the central government $15 billion or 15% of its total budget. Only recently, between 2002 and 2010 did private investment exceed government-led spending in the private sector, but in the same period the government has spent $3.20 billion every year to spur growth in the agricultural sector. By 2010, the unemployment rate stood at 10.0%, a remarkable improvement from its level of 23% in 2004, and 13.8% in 2007. Youth unemployment, and for university graduates remain very high at 21.5%, and 21.4 % respectively in 2010; these figures are likely to get worse in the immediate future as 300,000 new job applicants enter the labor market yearly, and a significant proportion of the unskilled are excluded from the formal economy. The Country Report by BTI (2012) provides further reflections on this aspect of the Algerian state of affairs:

“Despite undeniable recent achievements, the fact remains that Algeria is an educational underachiever compared to its overall human development level. The country ranks 127th out of 179 countries in the 2009 UN Education Index. Because of inadequate investment in all levels of education, Algeria suffers considerably from a brain drain by which promising Algerian graduates of universities abroad often feel the draw of better pay in their host countries and do not return home. According to the Oxford business Group, the emigration of researchers and specialists in recent years has meant an estimated loss of $40 billion for the country. The government has responded by tightening the system of students’ scholarships.”
Pervasive bureaucratic corruption at federal, state and local administrative agencies continue to hamper economic development as badly needed foreign capital is discouraged from entry into the country. The 2010-2011 Global Competitive Report ranks the country as being uncompetitive in attracting external private funding, and gives account of rampant corrupt practices in government sponsored construction projects, and in the bidding process for government contracts. The cumulative effects are devastating to development efforts; in 2010 Algeria’s Human Development Index ranked below that of resource-poor Tunisia and Jordan, and the country continues to feature high levels of absolute poverty with 23% of its population living on less than 42 per day.

On Indonesia

Indonesia, while one of the world’s oldest exporters of oil, shares limited similarities with newly independent oil-states. Because it had built up significant state capacity before it realized the windfall from the oil boom, it was able to avoid much of the disruptions caused...
in the new oil-exporting states. Since its state formation was not coincidental with oil, it
adopted development strategies that relied less heavily on oil, and until 1968 taxes from oil
was about 1% of GDP. But this soon changed; by 1986 revenue from oil taxation rose to
10% of GDP, and the oil industry constituted over 30% of the overall economy. The
economy was now exhibiting strong evidence of heavy dependence on oil as production
rose dramatically between 1968 and 1973, and expenditure on further oil exploration
spiked. In short order, the economy began to manifest the damaging characteristics of a
rent-seeking economy, i.e. pervasive government involvement in all sectors, stifling
bureaucracy, and corrupt practices. But Unlike its oil-exporting counterparts, Indonesia
provided strong support for its agriculture sector while increasing spending on education
and heavy industries. As a result its rice production grew by an average of 4.5% annually
from 1968 to 1978, and with time became an exporter of rice, and other agricultural
products. This aspect of Indonesia’s development strategy distinguished it from others
because it adopted a balanced approach to development that included significant reliance
on taxation of non-oil sectors, a diversified economy, and institutional flexibility. These
allowed it to follow a much different development trajectory.
With the ascent to power in 1966, Suharto installed an authoritarian government that
prioritized economic development over democratic and political institutions. Backed by a
strong military, the government embarked on extensive public works projects that
systematically transformed Indonesia from a poor country to a lower-middle income
emerging economy. Suharto achieved this through a network of businesses sympathetic to
his goals, and the enlistment of family members. The effort to develop the country
economically began by concentrating on productive activities that were labor-intensive,
and in the process maintained a tight control of labor unions; with concessions from labor,
production costs were minimized, and firms were able to realize health profits, which in
turn spurred further investments in the domestic economy. This development effort,
however, came at a substantial cost. For, in spite of its ability to manage the windfalls from
oil much better than its newly independent oil states, similarities soon emerged as the
government of Suharto succumbed to the temptations of rent-seeking behavior, and
bureaucratic corruption. But while these symptoms of resource-led development were
reasonably serious, their consequences on the economy were minimal; the state’s
institutional capacity was well developed to contain the damages.

By 1990, Suharto's development model, characteristic of those adopted by newly emerging economies in East and Southwest Asia, engendered remarkable progress. By 2009, the domestic economy had become very robust, and now accounts for two thirds of its Gross Domestic Product. This strong performance of its economy has made it possible for FDI to grow proportionately, attracting more foreign investors every year since the ouster of Suharto in 1998.

**Indonesia's statistical profile in 2010**
Population: 230 million
Adult literacy: 92.0%
Fertility rate: 2.2
Human development Index: 60

**Economic performance in 2010**
Gross Domestic product: Rp5,613 trillion ($540 billion)
GDP per capita: $2,350

**Origins of GDP**
- Agriculture: 16%
- Industry, of which Manufacturing: 27%
- Services: 35%

**Components of GDP**
- Private consumption: 57%
- Public consumption: 10%
- Investment: 31%
- Exports: 24%
- Imports: -21%

**Trade**
**Principal Exports**
- Mineral products: 20.2 billion
- Fats, oils & waxes: 12.1 billion
- Liquefied natural gas: 8.9%
- Petroleum & products: 7.8%

**Total incl. others: $116.5 billion**

Principal Imports:
Intermediate goods: 69.7 billion
Capital goods: 14.0 billion
Consumer goods: 4.8 billion

Total incl. others: $96.8 billion

The implementation of sound monetary and fiscal policies during the oil booms gave it the flexibility that ultimately proved very useful in combating declining oil prices, and depressed revenue. Early on, particularly in the late 1960s, it adopted a balanced-budget, and floating exchange-rate policies; it regularly devalued its currency to encourage exports, and discourage excessive dependence on foreign goods. The Budget-balance requirement imposed fiscal responsibility; in this regard Indonesia differed significantly from other oil-exporting countries.

Being a stable democracy helps. The installation of a progressive, and democratically inclined government after the departure of Suharto in 1998 was a major factor in Indonesia’s resurgence as a major economy, and as the third largest democracy in the world. In a country as extremely diverse with regard to ethnicity, religion, and culture, the
ability to unite competing interests and ethnic groups by crafting an acceptable national purpose, and a unifying single language (in this case Bahasa), the central government was able to develop essential political and social institutions necessary for political stability and economy growth. The global financial crisis of 2008 had little effect on Indonesia’s economy because policy makers had in place an inward looking trade policy that favored domestic production, but left enough room for transactions with major trading partners such as Japan, and a few Western countries. Although the economy has done remarkably well, about 60% of the country lives on less than $2 per day, and development in its rural and eastern provinces continues to lag behind the national experience. Inequality between the genders continues to be a national blight, for, despite encouraging and respectable progress in many socioeconomic vectors, Indonesian women remain seriously disadvantaged in earning capacity, and educational attainment.

### Economic Indicators

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<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<td>Inflation (CPI) %</td>
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<td>11.1</td>
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<td>Unemployment %</td>
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<td>Import Growth %</td>
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<td>17.3</td>
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<td>147621.8</td>
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<td>Total debt service % of GNI</td>
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<td>Tax Revenue % of GDP</td>
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<tr>
<td>Government Consumption % of GDP</td>
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<td>9.6</td>
<td>9.1</td>
</tr>
<tr>
<td>Public expnd. On edu. % of GDP</td>
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<td>2.8</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Public expnd. On Health % of GDP</td>
<td>2.5</td>
<td>2.3</td>
<td>2.4</td>
<td>-</td>
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<tr>
<td>R&amp;D expenditure % Of GDP</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Military expenditure % of GDP</td>
<td>1.2</td>
<td>1.0</td>
<td>0.9</td>
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</table>
The effects of international lending institutions, and WTO

The oil booms in the 1970s and 1980s that encouraged petroleum-led development in oil-exporting countries also encouraged profligate spending, lax fiscal policies, bureaucratic inefficiencies, and production bottlenecks that were sustained, in part, through accumulation of debt owned by foreign lenders. To leverage their ability to spend on state-funded projects, the countries borrowed heavily; international lenders were only too happy to oblige for they deemed these countries as risk-worthy. But the collapse of oil prices in the mid-1980s proved them wrong; Algeria, Iran, Venezuela, and Nigeria could not meet their debt obligations. In came the lenders of last resort – the IMF, and the World Bank.

In order to get needed help from these international financial institutions, all oil-exporting countries in need of help had to agree to the various ‘memoranda of understanding’ structured by the IMF that spelt out in great details the ‘conditionalities’ of their respective loan programs. This in effect placed the budgetary structures, fiscal and monetary policies of recipient countries under the guidance and supervision of the IMF and the World Bank. For almost all of these countries, the IMF imposed what it termed ‘structural Adjustment Programs’ that among other restrictions, required currency devaluation, removal of subsidies for domestic goods, minimal tariffs, and unrestrained international trade. They were also encouraged to place more emphasis on production of export-oriented goods, and to encourage direct foreign investments. Empirical evidence now shows that, for all oil-exporting countries that adopted the structural adjustment programs of the IMF and the World Bank suffered economic contractions in the ensuing years. The one size-fit-all model imposed on these countries failed to assist development goals for several reasons: it did not take into consideration the different levels of institutional capacities available in each country; it was based on a neo-classical trade model that assumed parity or near one on levels of economic development between advanced economies, and developing ones; but more damagingly, encouraged dependence on imported manufactured goods, thus atrophying domestic manufacturing sectors. Requirements by WTO for globalized trade through lower tariffs, liberalized capital markets, and elimination of trade barriers did not help matters.
Thus all through the 1980s and 1990s, the Washington Institutions propped their policy recommendations to heavily indebted oil-exporting countries of Iran, Algeria, Venezuela on a ‘three-legged stool’ of privatization, fiscal austerity, and market liberalization. When trade liberalizations are implemented at the right time, and at the appropriate pace, it can actually bring about real efficient outcomes in job creation, and growth in the manufacturing and agricultural sectors. The problem, however, is that the IMF and the World Bank, and WTO pushed these policies to hard and at a very fast pace in countries that lacked requisite institutional capacities. It is worth noting at this juncture that developed countries such as the US, Britain, and Japan, used protectionism quite effectively to promote and develop vital manufacturing sectors until they were ready for global competition. Joseph Stiglitz (2003), a former chief economist for the World Bank, was plain enough on this point:

“While blanket protectionism has often not worked for countries that have tried it, neither has rapid trade liberalization. Forcing a country to open itself up to imported products that would compete with those produced by certain of its industries, industries that were dangerously vulnerable to competition from much stronger counterparts industries in other countries, can have disastrous consequences – socially and economically. Jobs have systematically been destroyed – poor farmers in developing countries simply couldn’t compete with highly subsidized goods from Europe and America – before the countries’ industrial and agricultural sectors were able to grow strong and create new jobs. Even worse, the IMF’s insistence on developing countries maintaining tight monetary policies led to interest rates that would make job creation impossible even in the best of circumstances.”

Thus, by 2009, manufacturing as a percent of GDP in Algeria was 6%, and the contribution by agriculture was 11.7%. In 2007, agriculture’s contribution to GDP in Iran was 10.2%, in Algeria it was 8.02%, in Venezuela it was 4.2%, and Indonesia reached a high of 13.7% of GDP. By 2006, the manufacturing sector in Algeria fell to 5.5% of GDP; Indonesia, and Venezuela fared better with 27.5%, and 15.1% respectively. These countries debt service on external debts remain debilitating to the efforts to spur and sustain development efforts.

**Conclusion: A Common Outcome**
The petro-states of Algeria, Iran, Venezuela, and Indonesia exhibit similar development trajectory that is shaped by the discovery of oil, and its use to finance state-led economic growth. The growth model chosen, a resource-led one, discouraged development of non-oil
sectors, and shifted emphasis to petroleum for fiscal revenues. This shift altered the nature of the state, its economy, and fostered centralization of state power that enabled the expansion of the state's jurisdictional influence. The adoption of oil-based industrialization in each case resulted in marginalized social institutions through rent-seeking behavior, bureaucratic inefficiency, and corruption. It also brought about diminished capacity in non-oil sectors such as agriculture, and manufacturing which ultimately made reliance on imported goods and food necessary to satisfy domestic demand fueled by the influx of petrodollars, and bloated exchange rates. Indonesia was an exception to this norm, for it took early and necessary steps to develop and sustain its agricultural sector, and managed its exchange rates through regular devaluation. Ultimately, the policy choices underwritten by petroleum were path-dependent that led to underdevelopment of industrial capacities, debased private sectors, and economies increasingly dependent on the state for sustenance.

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Nations).