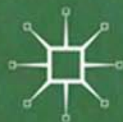
HOSSEIN ASKARI

COLLABORATIVE COLONIALISM

The Political Economy of Oil in the Persian Gulf



COLLABORATIVE COLONIALISM

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Collaborative Colonialism

The Political Economy of Oil in the Persian Gulf

Hossein Askari

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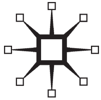

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To Rodrigo and Inês

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Naval Postgraduate School, Monterey xi

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Foreword

Robert E. Looney

Distinguished Professor, Naval Postgraduate School, Monterey

Would the Gulf region have been better off if oil had never been discovered? While it is difficult to come up with a credible counterfactual charting how development might have taken place in the absence of oil, Professor Askari's fascinating assessment leaves no doubt that oil's corrosive effects, both directly and indirectly, have been a blight on the region.

Like the lottery, the oil curse and its variants have intrigued observers for some time. Outcomes for individuals winning the lottery routinely range anywhere from a disaster—lavish living that often leaves the winner in the end divorced, financially ruined, and occasionally homeless—to the other extreme of the secure, comfortable life of a coupon clipper.

Unfortunately such a spectrum of outcomes stemming from the fortuitous possession of oil reserves has not developed in the Gulf. The result, outside of relatively small group of elites especially in the larger economies of Iran, Iraq, and Saudi Arabia, has in nearly all cases been a disaster—dismal economic growth rates except for short bursts of oil-financed growth, and even less satisfactory progress in most of the key measures of human development. The region is home to many lost lives and few coupon clippers. The social contract many governments forged with their populations during the oil boom years are now fraying under the weight of rising expectations and rapidly expanding populations.

Throughout the book one senses Professor Askari's disdain for the region's callus and often corrupt leaders as he leads us through the grim terrain: With oil-financed governments less accountable, the region's populations have experienced more repression and less in the way of freedoms relative to other parts of the world. The region has no doubt experienced more wars and conflicts than would have

occurred in the absence of oil. Outside interference from the major world powers has eroded the confidence of large segments of populations in their leaders, while radicalizing others.

With governments deriving large chunks of their revenues from oil, relatively little attention has been devoted to developing a dynamic private sector. In fact, many governments have gone out of their way to discourage entrepreneurship and the creation of private-sector wealth on the fear that competing power-base might challenge their authority. With stagnant private sectors and governments unable to fulfill their traditional role of employer of last resort, unemployment rates are soaring in countries even as well-endowed as Saudi Arabia. Even individuals that may have benefitted from subsidized food and fuel are facing the stark reality that their dysfunctional governments are unable to sustain these handouts and as such are facing the prospect of rapidly falling standards of living.

The associated Dutch Disease (strengthening of the real exchange rate) has impeded economic diversification and decimated agriculture in countries like Iran and Iraq, leaving many of the rural populations little alternative but an uncertain future in a unfamiliar urban setting. Iraq's per capita income today, despite having potential oil reserves possibly as large as those in Saudi Arabia, is probably what it was around 1950. Despite the mullahs' vow of radically changing the structure of the Iranian economy, little change in this regard has taken place since the shah's day.

Ironically the Arab spring forces sweeping through the region have brought little in the way of fundamental change in the oil countries. The government's large military and security budgets have helped preserve the regimes, while stepped up subsidies and handouts have bought a few more years of domestic peace. In short, oil has enabled governments to be unaccountable to their populations, pursue irresponsible and inept policies, and deny future generations their rightful legacy.

Is there any way out of this calamity? Orthodox economists from international agencies such as the IMF often point out that the solution is simple—economic reforms combined with improved governance in areas such as: control of corruption, rule of law, government effectiveness, voice and accountability, and regulatory quality.

Less orthodox observers suggest the countries should adopt some sort of institutional evolutionary approach such as the Chinese model—build on what works and gradually move their economies into the global economy, where competition, capital flows, and imported technologies will enable these countries to eliminate poverty and quickly catch up with their peers in other parts of the world.

Professor Askari knows the region all too well to subscribe to these naïve approaches. Realistically, few significant reforms are likely to proceed without an alternation of the relationship between the region's governments and the major Western powers. As Professor Askari documents, the interaction between the governments of the Gulf Monarchies, Western powers, and their oil companies has evolved into a form of colonialism—"collaborative colonialism," whereby first Britain and now the United States provide protection for the regimes, in return for secure oil supplies. An equilibrium has developed whereby collaborative colonialism enriches the Monarchies and their foreign supporters. The message is clear: it is US support that has impeded change.

With time, this equilibrium is likely to weaken as the United States becomes less dependent on Gulf oil. The shale-oil revolution along with expanded production in Iraq is likely to fundamentally alter oil markets, with prices and revenues set to decline. No longer being able to count on Western protection the Monarchies may turn towards China, but it will be some time before China will be able to provide adequate support and protection. With falling revenues and Western support in decline, the region's restive populations will be more and more difficult to control.

Clearly the countries in the region, especially the Monarchies, are on an unsustainable path. The stable equilibrium forged with the West is weakening, with Arab spring winds blowing in from all sides. Reading Professor Askari's book is like watching a train wreck from afar. You know a disaster is going to happen, and it's just a matter of time. Many authors, especially those in the West, might shrug at the hopelessness of the situation and end their assessment at this point.

Instead, Professor Askari provides a solution that embodies a basic sense of compassion and fairness that runs throughout the book. Without going into detail, his proposal for the creation of intergenerational oil funds provides for a fair, equitable, and hopefully peaceful transition to sustainable growth. As one might gather, while the book is titled political economy, it is much more. It integrates the region's economic history, politics, and religion with the author's deep sense of fairness and compassion for the population.

Professor Askari adds a fascinating personal touch to the volume by sharing some of his reflections as a privileged boy growing up in Iran. What if Mossadeq had not been overthrown? How might things have been different? Would the mullahs have come to power? Of course there is always the question of what the country would have been like without oil. An industrial rival of Turkey, with an Iranian Ataturk

leading reforms? It's interesting how these what-ifs have haunted him over the years—providing perhaps the necessary reflection and stimulation to undertake the current volume.

There are only a handful of people in the world who could undertake such a broad-sweeping account of this important region. Professor Askari's economic skills, understanding of Islam, knowledge of history, compassion, and basic sense of justice combine for a significant contribution to our understanding of the forces that have shaped the region and will continue to effect developments there. Hopefully his advice for the region's rulers will be taken seriously before it's not too late. Are there some things left out or incomplete? Perhaps, but if so all the better. I for one am eagerly awaiting Professor Askari's next book.

Preface

Over the years, Islam and oil have been the two principal forces shaping developments in the Persian Gulf and in the broader Middle East. While Islam has been the foundation and scaffolding for some 1,400 years, oil has been a relative newcomer in framing events in the region, with oil production initiated in Iran about 100 years ago, gaining global and regional significance after World War II and capturing global headlines beginning in 1973–1974.

Today oil and the Persian Gulf are by all accounts inseparable. It is tough to mention one without the other. Even other words that are commonly associated with the Middle East or the Persian Gulf are perceived as being inextricably linked to oil: cartels, boycotts, sanctions, terrorism, military expenditures, corruption, dictatorships, conflicts, wars, revolutions, foreign meddling, and, yes, even Islam. How did the countries of the Persian Gulf become so associated with oil? How have the political, religious, and social structure of these societies affected the way oil has been exploited, and in turn, how has oil affected these societies—their human, political, and economic development, and their relations with the outside world? What does it all mean for the future? We examine these questions and implications of oil for the Persian Gulf, or what one might loosely label the "political economy of oil in the Persian Gulf." As we will see, over the last 75 or so years, most of the significant developments in the Middle East region are in some way related to oil—inefficient institutions, the absence of the rule of law, corruption, economic failure, wars and conflicts, foreign interference, foreign relations, and more.

In short, the Persian Gulf and the Middle East conjure up Islam and oil, as Islam and oil conjure up the Middle East and the Persian Gulf. The Middle East, Persian Gulf, Islam, and oil are words that have become almost inseparable to most of our minds.

Before the discovery of vast quantities of oil in the Persian Gulf, the countries (or in some cases sheikhdoms) were poor (especially those

that had little non-oil natural resources, such as Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates), politically and socially backward, and looked to the West for direction. Today, a century later, the countries of the region are much the same, but with a façade of unimaginable wealth and ostentatious living on the part of rulers and their supporters—especially in the countries that have extraordinary per capita oil (and natural gas) wealth—more regional conflicts, and more foreign meddling than ever before in the affairs of the region. While most former colonies have been cut loose, countries of the Persian Gulf, though technically not colonies, have been pulled in the opposite direction and arguably reined in. What has been the political and economic manifestation of oil—the political economy of oil—that has shaped the region in this way? Will the future necessarily be the same?

We hope to demonstrate that the production of oil and the promotion of weak institutions (because effective institutions undermine corrupt rule) in the Persian Gulf countries have harmed citizens politically, socially, and economically, possibly leaving some countries worse off than had oil never been discovered on their land. While a number of these countries may appear to have been transformed with high levels of per capita GDP today, their economies are fundamentally unsustainable (built upon the depletion of oil) and unstable (with an unjust foundation and little popular backing). In support of this proposition, we make four essential claims: (i) effective institutions are at the foundation of political, social, and economic progress in this region just as they are in any other region, but their development has been undermined by unelected rulers who are motivated by the accumulation of wealth for themselves and their supporters; (ii) oil has not only hindered the development of good institutions but also skewed the interests of rulers and elites to such an extent that they actively prevent the creation of sound institutions; (iii) although all Persian Gulf countries were exploited by the governments of colonial and neocolonial powers in the past, today most of the rulers of these countries solicit the support of those same foreign governments, their current and former senior government officials, their multinational companies, and their influential lobbyists to exploit their own countries for personal gains—what we will call "collaborative colonialism"; and (iv) with so much wealth at stake, foreigners have not given up control of these countries (though not technically colonies), as they more or less did with former colonies, nor have these countries freely developed with all the ups and downs that the process entails. We believe that the discoveries of vast quantities of shale gas around the

world and the increasing competitiveness of unconventional crudes (from shale and tar sands) and renewables have definitively changed the global energy outlook. As a result, the countries of the Persian Gulf have less time than they might have ever imagined to transition to "oil-less" economies. In the process, we will address and expunge a number of popular myths, including: the United States supports dictators to maintain stability and to guarantee the "flow" of oil at a "reasonable price" for the United States, its allies, and the world at large; and Islam impedes development and progress.

Our goal is to shed light on how oil has affected the region's political, human, and economic development, its external relations, indeed its fabric, and why there is more urgency than ever before to adopt foundational political and economic reforms. In the first half of the book, we take a chronological look at how the political structure of these countries and their relations to the outside world affected the exploitation of oil, how the role of oil grew, and how oil extraction shaped political and economic developments in these countries over the past one hundred years. In the second half of the book, we explore the impact of oil on development and on conflicts in the region as well as on the region's relations with the world at large. We examine how foreign interests in the region first exploited the region's oil as colonialists and then supported rulers to exploit the region's wealth as collaborative colonialists. We conclude by suggesting how the role of oil can be transformed into a positive force in the future as the region transitions to non–oil-based, or oil-less, economies.

We have endeavored to limit our use of tables, graphs, and data. Instead, we hope to present a narrative that is sufficiently clear to require little use of numbers. For the reader wanting more background and explanation, we provide a little extra information in a number of short appendices.

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Part I

The Evolving Role of Oil in the Persian Gulf

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Chapter 1

Before Oil—Political and Economic Conditions in the Persian Gulf

To set the stage for how the discovery of oil, its production, and its sales have affected the countries of the Persian Gulf, it may be helpful to begin with a simple collage of how these countries appeared at the beginning of the twentieth century and in the period before oil revenues started to flow. What were the states of institutions, political structure, foreign involvement and societal edifice, and economic conditions in the countries of the Persian Gulf? Were they like peasant economies the world over and was there outside meddling in their affairs as in other former colonies?

Iran

Government and Politics

Iran's strategic location between Asia and Europe had for centuries attracted the attention of the great powers, and specifically in the late nineteenth century Russia and Great Britain saw potential in Iran for expansion of their trade routes. In the late eighteenth and nineteenth centuries, during the Qajar dynasty, the shahs of Iran were in need of revenue. The shahs had little choice but to grant trade concessions in everything from tobacco to arms to the British and the Russians in exchange for fees and loans, affording the outside powers great leverage and control over Iran's internal affairs.[1]The shahs used these funds in part to finance their lavish lifestyles by pledging Iranian custom revenues, their principal income. As a result, Iran became more exposed to and influenced by Western culture and values that in turn affected its political, social, and economic dynamics. The influence of Western ideas was problematic for those (the religious authorities)

who advocated Islamic values and those (the nobility) who supported traditional values, creating the grounds for opposition and demands for reform. The result was the Constitutional Revolution of 1906. Ironically, the unintended consequence of the constitutional movement was to increase foreign involvement in the country. As for domestic politics, the outcome of the constitutional movement was the creation of "superficial parliamentary rule with almost no foundation laid and no real leaders."[2] There was no dominant or coherent party system and no dominant figure. All in all, the political structure was too dependent on foreign support, and attempts to address the issue were stymied by the onset of World War I.

In 1907, the Anglo-Russian Agreement was signed, but despite the intention to respect the integrity of Iran, the "net result for Persia was further entrenchment of foreign powers on her soil and further weakening of the control of the Teheran government over the zones under the influence of Russia and Great Britain."[3] This entrenchment was a pattern that would carry on throughout World War I and into the interwar period. Between 1911 and 1921, it became increasingly apparent that Iran was becoming less independent, a fact that was confirmed during World War I when Iran came under the direct control of the British and the Russians. The war also paved the way for Reza Khan to overthrow the Qajar dynasty in 1925 and become shah. Reza Shah Pahlavi was determined to modernize and westernize Iran. He introduced civil laws, banks, and other institutions to promote Iranian independence. However, the unique social conditions in Iran remained a challenge, as the religious authorities (*ulama*, clerics, or mullahs) remained opposed to modernization and further opening, or concessions, to Western cultural influence.

Society

At the turn of the twentieth century, Iranian society became "characterized by a growing split between religious and temporal authorities, by the emergence of a socio-political leadership among the *ulama,* and the creation of mass oppositional movements with a religious component."[4] The clerics were an integral and important part of Iranian society and were opposed to the westernization championed by the Qajar shahs. They felt threatened by the growing European interference and influence, and by 1905 became the leaders of the opposition movement and the driving force behind the Constitutional Revolution.[5] Despite the European presence, the government refrained from westernizing the education system and from promoting the

foreign education of privileged Iranians. Iranian students, by and large, continued to receive a religious education, allowing the clerics to maintain their influence, position, and power. In the absence of significant national economic development and widespread prosperity, the influence of the clerics continued to grow because the masses resented foreigners and the privileged lifestyles of their leaders. In the absence of good transportation and communication, the Qajars had limited control over the provinces. As a result, in the areas where the clerics were in control, "there was no serious reform—education and justice remained in their hands, as did the charitable works that would later become social services."[6] Thus, in the early part of the twentieth century, Iran remained essentially a seminomadic, peasant farming, traditional craft and trading society, with regions that were not integrated into the central government. Reza Shah tried to modernize the country and reduce the role of religion in the footsteps of his hero, Mustafa Kamal Ataturk in Turkey, but with little success. The lack of progress and growing foreign interference and influence were not supportive of a cohesive society. The privileges granted to the British played an important role in destroying the livelihoods of merchants and craftsmen in Iran and alienated them from the central power structure in Tehran.[7]

Economy

At the start of the twentieth century, the Iranian economy had long been stagnant, underdeveloped, and largely agrarian, with a marginal global role. Because policy makers had paid little attention to economic growth, any spurt in growth was short-lived and directly attributable to government policies. But as political divisions grew and became more pressing, the attention to economic development and growth declined, and Iran fell deeper into economic stagnation.

At the beginning of the twentieth century, Iran's per capita income was between $900 and $1,000 (in constant US 2000 dollars at purchasing power parity), which was less than one-third of the average per capita income in Western Europe at the time.[8] The country's conditions were undeniably backward. Manufacturing was limited, and most income came from the land. Outside of agriculture, the major activities were carpet weaving and textiles, but overall revenues were too low to support the population or expand the country's trade. That said, Iran was still much better off than other countries in the region of the Persian Gulf. The per capita income was above the global average, and the economy was near the bottom of the list of the 30

largest economies in the world. After the Constitutional Revolution in 1906, the political turmoil that persuaded foreign powers to interfere increasingly into Iranian affairs led to economic decline. With the beginning of World War I and the disruption of trade with Russia after the Russian Revolution and the famine in 1917 and 1918, economic decline intensified.[9]

Still, the country's meager oil revenues remained indispensable. The economy took an upswing with the elevation of Reza Shah in 1925. Over the course of the Pahlavi era, the economy of Iran improved, with educational, infrastructural, and legal reforms. The new shah pushed Iran through a period of modernization, with a series of development projects. Nonetheless, economic development policies throughout his time were less than consistent, and as a result, in the interwar years, growing debt and shortages of basic goods plagued Iran.

Iraq

Government and Politics

The triumph of the British over Turkey in March 1917 marked the beginning of British influence in Baghdad. It would be safe to say that the arrival of the British marked the beginning of a new Iraq, an Iraq with a more modern government.[10] Applying its long-tested colonialist practices, Britain brought Baghdad under its direct political control and divided the country into administrative districts under its control. Although the British recognized the existence of an Arab monarchy and administration in Baghdad, the purpose of this government was to "carry out the burdens of governing the three ex-Ottoman provinces of Baghdad, Mosul, and Basra under British guidance."[11] As a result, the local population was excluded from all political participation and power.

The shape of Iraq was formally declared to the world in October 1922, when the council of ministers ratified a treaty that placed the country under British Mandate. The treaty provided that the king would have to resort first to British advice on all matters affecting fiscal policy, economic development, and British interests. The British occupation resulted in a wide range of conflicting local demands and shifting attitudes. While the "townsmen and villagers desired restraints against tribal incursions, the tribal sheikhs, on the other hand, wanted the government to confirm their titles to tribal territories and to give them new land as well."[12] Moreover, merchants called for more effective legal procedures while municipalities appealed for defined powers and greater grants-in-aid.

"About a decade later, after Iraq became a sovereign state on October 3, 1932 and the British Mandate was terminated, the government possessed adequate financial means to cope with many of its internal problems because of growing oil revenues; oil had been discovered at Naft Khaneh (about 90 miles northeast of Baghdad) . . . and by 1930 oil products were being exported."[13] This financial leeway however did not erase the government's problems. Among the issues, and perhaps the central issue, was the deep-rooted Shia-Sunni conflict. Although the Sunnis had more administrative experience, the Shias, who were "at the time constituting 50 percent or more of the population and being very conscious of the presence in Iraq of so many Shi[i]a holy places, began to fear the possibility of complete Sunni domination in government."[14] Another issue was to the north where the Kurds sought independence. Thus, with the death of King Faisal in September 1933, who had been recognized for his stabilizing personality in the political life of the newly created state, Iraq saw the fallouts from these issues intensify and factionalism increase.

During this period of absence of stability and authority, there was an "increased desire for an effective role of government in promoting national welfare."[15] A wave of oppositional movements ensued. Specifically, the public expressed a "growing demand for general reform, including measures in the spheres of land improvement and distribution, road building, irrigation, commerce, industry, public health, and communications."[16] To capitalize on these demands for their own interest, the military began to inject itself into the political scene, leading to military involvement in the October 1936 coup d'état. When World War II broke out, Iraqi relations with the European powers were further severed, and in 1943 Iraq declared war on the Axis Powers. Nationalism continued to dominate the political scene well into the 1950s.

Society

Under the British rule, the social divisions and diversity that characterized Iraq's early history were exacerbated. Since its inception, the Iraqi state consisted of "a diverse medley of peoples who have not been welded into a single political community with a common sense of identity."[17] In line with the general pattern across the region, Iraq's social structure consisted of nomadic communities, village societies of cultivators, and the urban centers of commerce and government, each with its own system of social stratification.[18] The tribal organization and institutions and the settled village community were the backbone

of the social structure and political life in Iraq, and created a highly stratified class system. In the political life, the family, clan, tribe, and local ties were more important that national loyalties.[19] Moreover, ethnic, religious, and linguistic differences shaped and challenged the development of Iraq.

Between 1918 and 1958, "a period during which Iraq achieved independence and a greater role in world affairs, some important changes took place in the social order."[20] Specifically, "access to prestige and power became freer than it was in the traditionally authoritarian and highly stratified system."[21] In general, however, "the major outlines of society remained more or less as they had been for centuries, with nomad camps, villages and towns continuing to define vastly different ways of life."[22] After the revolution, living conditions in the cities and towns improved modestly, but in the rural areas many people were living at a subsistence level. In the 1920s, the government initiative in welfare, mostly in the form of public works projects, took place. These included flood control and irrigations projects, which helped increase crop yields. There still remained issues associated with "inadequate roads and [a] lack of transportation and communication [which] isolated some communities from the services that would otherwise be available from provincial authorities."[23] As for education, the British Mandate in 1920 led to a gradual expansion of Iraq's public primarily school system under British supervision, and the country's first secondary schools were opened, but overall, a large portion of the population remained illiterate because the educational programs received fewer funds in order to limit the number of graduates who could challenge the bureaucracy.

Throughout the 1920s and early 1930s, the cities and towns began to witness the rise of a small middle class, consisting of civil servants, professionals, and merchants.[24] However, the majority of the population was still very poor. Many people became engaged in the oil industry, but due to lack of funds and slow growth, the fruits of their labor were minimal.

Economy

In the traditional economy of Iraq, agriculture and herding were of paramount economic importance. The cities of Basra, Baghdad, and Mosul had political and economic power at the end of the Ottoman era, but beyond these cities, the country was mostly "caravan stops like Zubair, fueling stations like Kut, or religious shrines like Karbala and Najaf, in which the benefits of law and order, trade and

manufacture, were noticeable only against the background of poverty in the countryside."[25] Before World War I, "the tribal sheikhs took control of large tracts of land and because the landlord customarily received the major share of the produce from the land, the system provided a minimal subsistence to the majority of those who worked the land and left them with little incentive to increase production."[26] Land was largely neglected for a long period of time before World War I, a trend that continued with salification and alkalization of the land. While some progress in irrigation and the introduction of new crops had been made, the benefits were reaped largely by the politically powerful and the wealthy.

Between 1920 and 1932, oil attracted Western interests. At this time, the industrial sector did not play an important role in Iraq's economy because "businessmen lacked both the financial means and the technological resources to develop manufactured goods for the foreign market, and they found the domestic market highly restricted."[27] The majority of funding went to paying for the building of facilities by the British, which took resources away from expanding oil production. As a result, by 1932, as much as 70 percent of the population, was "virtually untouched by modernization and modern industry."[28]

Bahrain

Government and Politics

Bahrain is made up of 30 small islands located near the western shores of the Persian Gulf. Surrounded by Saudi Arabia to the west, Iran to the north, and Qatar to the southeast, Bahrain's location has afforded it influence in the region. From 1602, Bahrain was under the control of the Persians (Iranians) until the Al-Khalifa family, members of the Bani Utbah tribe, expelled the Persians and took control of the islands in 1783. Besides Iran, Portugal and Oman have also ruled Bahrain at one time or another. Bahrain's strategic location as a trading hub fostered competition among foreign powers for its control. The country's rich social diversity helped fuel and exacerbate these claims. These competing interests in Bahrain created instability in the island. But with the arrival of the Al-Khalifas, political and social instability settled down as they helped "bring peace and security to Bahrain."[29] However, they did not do this alone. Because of Bahrain's location between larger countries, the "ruling family has historically sought security guarantees from larger powers . . . and made overtures to the Ottoman Empire and even the Persian Empire before developing a closer relationship with Britain."[30]

The relationship with Britain officially began in 1830, when a series of treaties between the Al-Khalifas and the British established a protectorate relationship to defend Bahrain against external powers, such as the Sultan of Oman. The British became particularly interested in Bahrain as they began to develop an interest in the broader region. To the British, Bahrain was strategic, because it would help secure maritime trade routes between India and the Persian Gulf. The treaties of the 1830s were important because they marked the beginning of long-term British involvement in Bahrain's domestic and foreign affairs. Although the British gave critical support to the Al-Khalifa family, the relationship robbed the Al-Khalifas of some of their sovereign rights. For instance, the treaties prevented the Al-Khalifas "from fighting to regain territories they had once held on the nearby Qatari peninsula."[31] In the 1920s, the protectorate relationship expanded to include greater British involvement in Bahrain's domestic political affairs. The country came under the direct administration of British personalities (British political agents), who held considerable decision-making powers. A notable figure was Major Clive Daly, who was especially active in Bahrain's legislative and economic affairs. Throughout the 1920s, these administrators began to force their opinions regarding the ruling family itself, and in 1923, British officials "compelled the ageing ruler, Sheikh Issa bin Ali Al-Khalifa, to step down after fifty-four years in favor of his son and heir apparent, Sheikh Hamed bin Issa Al-Khalifa."[32] In the aftermath of the change in rulers, the British were given more power with the new ruler appointing numerous British officials to advisory positions. The British effectively controlled every decision of the new ruler. During the 1920s, the British established many administrative structures, from the court system to modern schools.

As for the economy, British political agents, especially Daly, weakened the financial power of the Al-Khalifas, who had been taking most of the revenues from the pearling industry. Major Daly "took control over the customs revenue, previously the Al-Khalifa's main source of income, and instead paid the sheikh a stipend."[33] In 1924 he also "restructured the pearl industry, weakening the control of the Sunni pearl merchants and, at least in theory, giving more rights to the debt-bonded pearl divers."[34] This upset the merchants, who had tried to use their own financial power to check the power of the ruler. Bahrain remained under the protectorate control of the British until 1971, when it achieved its independence. However, despite independence, Bahrain continues to be controlled by foreign powers to this day, especially Saudi Arabia.

Society

In the pre-oil era, Bahrain's society was based on a patriarchal system, strongly influenced by tribal backgrounds, affiliations, and economic status. Because of Bahrain's position as a trading center in the region, the population was ethnically mixed between Bahraini Arabs (of which a majority are Shia), Persians, and Asians. The population of Bahrain expanded with the discovery of oil, but it was, and still is, considerably smaller than the populations of its neighbors. In 1941, soon after the discovery of oil, the population of Bahrain was about 90,000 people, of which 16 percent were foreigners; by 1971, the population was up to 216,078.[35] Between the 1920s and the 1950s, the period in which the British were directly involved in Bahrain's local affairs, the country underwent rapid social transformation and development. Bahrainis had already been experiencing the benefits of trade and pearling, both directly and indirectly through the government's expanding welfare system. Bahrain's state education system began in 1932, with the government assuming responsibility for two existing primary schools for boys. In addition to free education, the government had also been providing universal health care since 1925, well before the discovery and development of the oil industry. A high percentage of the population was literate as far back as the late nineteenth century because education was considered a priority by the government.[36]

In addition to traditional values, its economic activities, namely, pearling and trade, also shaped Bahrain's small population. The merchants were powerful, both financially and politically, because they were able to use their financial wealth to check the power of the Al-Khalifa family. Persians, Indians, Sunnis, Shias, and Jews, all sorts of ethnicities, helped Bahrain develop into a culturally rich country. It should be noted, though, that despite the "melting pot" society, barriers still existed between different social classes. It was not until the discovery of oil that these barriers were lowered, with people of different ethnicities and religious backgrounds cooperating closely to develop the oil industry.

Economy

Before oil, Bahrain depended on its natural resources—both sea-based and agricultural. In the early twentieth century, Bahrainis were dependent to a great extent on the fishing and pearling industries. During the 1920s, more than two thousand pearling and fishing boats were in operation each season and were manned by about 20 thousand

people. Although there were also opportunities in raising date palms, the collapse of the pearling industry (with the Japanese invention of cultured pearls) and the onset of the Great Depression drove incomes significantly lower. The number of boats in operation dropped to 436 by 1933 and to a mere 12 by 1953. As a result, government revenues from pearling, which had been £103,333 in 1926, declined to £35,378 in 1933. The government was forced to cut payments and reduce expenditure on public health, education, and services—which expectedly took a toll on society. The pearling slump, however, impacted Bahrain much less than the neighboring countries because of Bahrain's historically established post as a trading center in the region, as well as its reliance on date palms. Its fresh water supplies allowed Bahrainis to fall back on traditional date palm cultivation and other agricultural production. Soon after, oil came on line and it did not take long for the government to receive higher revenues.[37]

Kuwait

Politics and Government

Although Kuwait was never a British colony, it remained under the British Protectorate for a period of about 60 years. However, even so, the British presence was minimal and there were never British troops or other forms of imperial presence in the country. The factors contributing to the political emergence of modern Kuwait took root in the latter part of the nineteenth century. Kuwait saw the rise of a remarkable ruler, Mubarak, who "began to play for stakes on the world stage, skillfully exploiting the rivalry of the great powers that sought his favors and turning that rivalry to his country's advantage."[38] As he established himself in the Arab World, Mubarak also believed that his country's fortunes lay with the British, but despite his friendship with the British, he wanted to prevent their direct interference in internal Kuwaiti affairs.

Kuwait had remained outside the British sphere of influence until 1899, when the ruler of Kuwait signed a non-alienation bond with Britain and undertook not to receive any foreign agent or representative without British approval.[39] Up until this time, Kuwait was characterized by popular participation in government and an integral relationship between the Al-Sabah ruling family and the people. Specifically, a special relationship existed between the ruling family and the merchant class, who, through great financial investment and contributions, supported the legitimacy of the Al-Sabah rule. This relationship took the form of an unofficial agreement: in return for financial support, the

rulers granted the merchant class favorable economic and investment climates and conditions and protected their families and fortunes while they were away on the high seas on business. To the important merchant families, the Al-Sabahs were more their designees to look after things while they were away than their rulers.

This relationship was successful until about the mid-nineteenth century, when the merchant class began to become more financially prosperous and influential than the Al-Sabahs. Around the time of these developments, the rulers turned to the Ottoman administration in Iraq and began to establish ties with Basra, which allowed them to possess new and independent sources of income apart from that of the merchants. As a result, the political environment became strained, and between 1892 and 1896 Kuwaiti ties to the Ottoman-Iraqi administration intensified while ties with the merchants weakened. Moreover, the growing relationship with Britain under the reign of Mubarak the Great (1896–1915) further weakened relations with the merchants, who began an opposition-like movement that ultimately took its toll on Kuwaiti political life.

The treaty between Mubarak and the British remained intact until 1961, with significant influence on the country's development. The treaty granted Britain control over Kuwait's economic and external affairs, and essentially prevented Kuwait from awarding oil exploration concessions to anyone without approval from Britain in return for naval protection.[40] Throughout World War I, Kuwaiti rulers displayed loyalty to the British, but this loyalty had ramifications when it extended to the Palestinian cause. Kuwaiti merchants were angered by the unwillingness of their ruler to provide assistance to the Palestinians against the British, which sparked an era of opposition. The merchant class, which was once close to and in line with Al-Sabahs, became the nucleus of this political opposition that called for elections, development, and political reform.

Society

At the beginning of the twentieth century, Kuwait City had around 50,000 inhabitants, who enjoyed a relatively stable life in comparison to their nomadic kinfolk, and about 500 shops, three schools, and nearly 700 pearling boats employing 10,000 men.[41] The majority of the people were poor and had to work hard to scratch out a living, and common Kuwaitis lived in homes made of mud. A major issue was access to fresh water, which required dependence on the goodwill of Ottoman governors in Basra, who at the time had control over

the flow of water to Kuwait.[42] The arrival of Mubarak to power had a positive impact on the people of Kuwait, because he began to lay the foundations of a modern state. Beginning in 1912, he established postal and telegraphic services, water-purification plans, and government welfare programs that catered to public schools and hospitals. Due to these efforts and the revenue from the pearling industry, Kuwaitis were able to lead stable lives, but overall, the majority of the population of about 35,000 in Kuwait City remained poor and uneducated.

An important part of Kuwaiti society was the merchant class, who were heavily involved in investment opportunities and financial ventures that provided revenue for the country, from date plantations to finance and commerce.[43] "Kuwaiti merchant families grew up as trading dynasties centered on Kuwait, but with an intricate network of relationships, often based on kinship, which spanned the Middle East . . . and it was these merchant families which provided that echelon of social and political leadership to the country and gave it that special brand of mental adroitness and financial astuteness which characterizes it today."[44] In addition to being important to Kuwait's economy, the merchant class was also important as the link between the Al-Sabahs and the population at large. The merchants provided badly needed jobs and filtered popular social developments and needs to the Al-Sabahs.

Economy

The pre-oil economy in Kuwait had three important features: (1) the accumulation of wealth from the eighteenth century through trade, (2) the stability provided by the Al-Sabah family, and (3) the absence of a welfare state. Before the discovery of oil, the emir was dependent on taxes and customs duties collected from the population. By providing stability to the merchant class to engage in economic activities, commerce increased, thus providing more revenue for the Al-Sabahs and providing jobs for the population at large. This arrangement worked well for Kuwait, which was able to flourish better economically during the nineteenth century compared to any of its neighboring states, with the exception of Iran.

During the nineteenth century, Kuwait's economic activities were based entirely on trade and the sea, and as in the neighboring Trucial States, major activities in pre-oil Kuwait were pearling and fishing. In comparison with their counterparts in the other Gulf emirates, Kuwaiti merchants were more aggressive and successful and earned

steady profits that exceeded the norm, making Kuwait economically better off than all neighboring Arab states in the late nineteenth and early twentieth centuries. The availability of Kuwaiti fishing boats served as trade-carrying vessels that brought the demand for luxury items (mostly pearls) to the West. Kuwait, strategically located near the world's richest natural pearl banks, was an important source, allowing for great profits. In 1906, Kuwait was known to possess 461 boats that employed over nine thousand men in the pearl trade. Along with the families they supported, the pearl fishermen represented about one-third of the country's population at the time.[45] The industry continued to expand, employing as many as 15 thousand people at its height. However, as was the case with the other pearl and fishing-dependent states in the region, the industry in Kuwait was greatly affected by two external events in the 1920s: the global depression and the creation of cultured pearls by the Japanese. The result of these two events was devastating for Kuwait. Between the 1920s and the 1930s, Kuwait experienced extreme economic hardship that took a heavy toll on the population as a whole, including merchants who were traders. The resulting economic strain was exacerbated by a Saudi economic blockade. The pearl-based economy collapsed, and as a result, Kuwait became poorer than it had ever been and turned to Great Britain for help.

Oman

Politics and Government

Between 1870 and 1920, Britain's interest in Oman was a by-product of its heavy involvement in India, as well as its enhanced preoccupation with the region following World War I. The modern state of Oman was shaped by this interaction between the Sultanate and British external domination or intervention.

By 1800, when British involvement in the region became more and more evident, the Sultan of Muscat formed an alliance with the British that would allow him to advance his aims. Throughout the nineteenth century, the Sultan and the British developed a close alliance, which quickly morphed into British domination of the country's political and economic activities. Over time, the British became more involved in Omani affairs, and in 1871 they assisted in restoring the Sultan to power. At this point, Muscat became a de facto protectorate. In 1886, "a formal guarantee was given to Sultan Turki to uphold him against aggression [and] from the 1890s, the British instituted a forward

policy in the Gulf which ever more tightly controlled the foreign relations of the sultanate." This was sealed in the 1891 British-Muscat treaty "in which the Sultans promised never to cede any territory to a third power [which] was the closest Oman came to being formally part of the empire."[46] From the 1920s onwards, Britain became more and more involved in overseeing the internal governmental affairs of the Sultanate, as well as controlling its foreign relations. This interference shaped the economic, social, and political development of the country. Oman was quickly integrated into a more capitalist economic system, ruled by a British-created council of ministers, which was ultimately answerable to the British government.

Society

Starting in 1932 under the rule of Sultan Said and his father Taimur before him, Oman was cut off from the rest of the world and existed in a backward state, which makes its transformation and economic developments all the more remarkable. During this period, "the majority of the population lived in a society akin to that of the Middle Ages with no general education, no health services, poor internal communications and repressive petty restrictions on personal freedom."[47] Illiteracy rates were substantially higher than anywhere else in the region (as late as 1969, only 900 children out of a population of 666,000 were enrolled in school).[48] Rather than adapting to the wave of modernism that swept the region, Oman remained isolated, traditional, and backward. It was not until the discovery of oil and the development initiatives of Sultan Qaboos that Oman gradually opened up and embarked on a path of modernization.

Economy

Oman's pre-oil state can be described by one word: poor. Prior to the era of modernization under Sultan Qaboos, Oman's economy was largely based on traditional activities, and consisted of a "large agricultural sector that used technology with low levels of productivity."[49] When Taimur came to power in 1939, he initiated an economic development plan that he believed would boost development without increasing the country's debt; the results were, however, unimpressive. Rather than improving the economic status of the country, he instead created a "reversal of Oman's fortunes with policies that opposed change and isolated Oman from the modern world."[50] As other neighboring countries, such as Kuwait, established welfare

states, Oman slipped into poverty, with high infant mortality and illiteracy. This remained the fate of Oman until Sultan Qaboos initiated development policies supported by oil revenues in 1970.

Qatar

Politics and Government

Before the discovery of oil, and especially gas, resources, Qatar was important for mainly one reason: its location. Qatar was always in the center of disputes and power struggles among the Gulf powers, and "in the mid-nineteenth century, the mild geographical isolation of Qatar, not so far from events but also an almost perfect place of escape, made it a magnet for exiles from various nations and tribes, exiles who have used Qatar repeatedly as a base for what the British called 'piracy' or for angry power-plays between surrounding sheikhs and Emirs."[51]

The expulsion of the Portuguese by the Turks in the sixteenth century had put Qatar under the nominal rule of the Ottoman Empire for a period of more than four centuries. Under the Ottoman system, sheiks from the Al-Khalifa tribe (the current ruling family of Bahrain) were the de facto rulers. In the mid-eighteenth century, the Al-Thani family succeeded in pushing the Al-Khalifas out, grabbed power, and has remained in power to this day. Originally nomadic Bedouins, the Al-Thanis settled in the coastal areas around Zubara, where they strengthened the pearling and fishing industries, the basis of economic activity in Qatar for years to come.[52]

In the early twentieth century, the land area of Qatar was split among several tribes, largely the Al-Thanis, the Al-Naims, and the Al Bin Alis. The first Al-Thani emir, Sheikh Mohammed bin Thani, established his capital at Al-Bida in the mid-nineteenth century, thereby laying the foundations of modern Doha.[53] In order to boost their competitive edge, the Al-Thani emirs turned to external powers, signing treaties that would allow them to strengthen their positions against the other tribes. In 1867, the emir signed a treaty with the British that established strong political ties. Later, the second emir, Jasim Al-Thani, turned to the Turks in 1872 and signed a treaty that allowed them to build a fort in Doha. This agreement and alliance with the Turks did not last long, however, as the third emir, Sheikh Abdullah, expelled them when Turkey entered World War I on the side opposing Britain. By this time, relations with the British proved dominant. After the expulsion of the Turks, the British "guaranteed Qatar's protection in exchange for a promise that the ruler would not

deal with other foreign powers without permission—an agreement that endured until independence on 1 September 1971."[54]

Although the Al-Thani ruling family formally announced its allegiance to the British in the 1868 Treaty, the Ottomans were still influential in Qatar and its territory until World War I. In 1916 a formal protection treaty was signed with Britain, but there remained direct political interference by the British until 1949, when the first large ship filled with crude oil left Qatar.[55] Prior to 1949, the Qataris had already experienced economic hardships, with the collapse of the pearl market and the limited oil exploration during World War II. However, with the influence of the British and their cooperation with the Al-Thani family, the "seeds of institutional development [were planted] in a way that favored certain entrenched tribal interests and placed Al-Thani firmly in a position to dominate governance and state building."[56]

Society

Prior to the discovery of oil (and gas), Qatar was plagued by widespread poverty, malnutrition, and disease, with poor economic conditions. As late as 1944, the Qatari population of only 16 thousand had practically no education and no direct contact with the world outside the Persian Gulf and Arabia, with more than one-fourth of the population directly engaged in pearl harvesting activities. Because of its nearly unbearable climate, Qataris were almost completely oriented toward the sea, with many Qataris living along the coast and having no permanent settlements in the interior of the country. In the late 1930s, a significant portion of the entire Qatari population (39 percent) were of African descent; however, World War II and the subsequent years saw falling pearl prices, which led to "a significant decrease in the number of expatriates and even an exodus of Qataris; compared with Bahrain and its much more established labor tradition dating to 1932 when oil was discovered, the influx of expatriate labor only really began in Qatar in the late 1960s."[57]

Economy

Prior to 1940, Qatar was less developed than the other nearby sheikhdoms of Kuwait, Bahrain, and Dubai. Doha was "little more than a miserable fishing village straggling along the coast for several miles and more than half in ruins. The souk consisted of mean fly-infested homes, the roads were dusty tracks, there was no electricity, and the people had to fetch their water in skins and cans from wells two or three

miles outside the town."[58] Qatar was a primitive and barren peninsula, with very little fresh water and severely limited cultivation. Thus, prior to the first oil concession in 1935, the only significant source of revenue for the emir came from levies on pearl-fishing ships and their captains.[59] Pearl fishing was the major domestic activity, "financed by local merchants who loaned ships' captains and divers money to set themselves up and then kept them in debt."[60] In 1944, about six thousand of the entire population of 16 thousand were engaged in pearl harvesting, demonstrating the importance and dominance of pearling in the economy. World War II and the subsequent crash of the pearling industry had a profound impact on Qatar and its economy.

Saudi Arabia

Government and Politics

In the early years of the twentieth century, prior to World War I, the Ottoman Empire had control over most of the Arabian Peninsula. At the time, the area of modern-day Saudi Arabia was ruled by a number of tribal rulers in cooperation with the Sharif of Mecca. Throughout the nineteenth century, these tribes competed for power over Arabia, but it was the Al-Saud tribe that was able to gain the upper hand after forming an alliance with the British in the mid-1920s. Pushing out two competing tribes, the Hashemites and the Rasheeds, the Al-Sauds formally established the Kingdom of Saudi Arabia in 1932 against a backdrop of competing narratives and sociocultural diversity within the kingdom.[61] The existence of competitive religious, regional, tribal, and factional sub-loyalties had made it difficult to establish an integrated society. Through craftiness and treachery Abdulaziz Al-Saud managed to unify the tribes. He established his family's political control and legitimacy on the basis of religion, proclaiming himself protector of Mecca and Medina, with the Quran allegedly as the constitution, and conceding religious matters to the Al-Shaykhs and the *ulama* in return for unquestioned political support. In desperate need of revenues, he did all he could to encourage rapid oil exploration and production, but with American companies as opposed to the British whom he did not trust, suspecting them of supporting the Hashemites who had migrated to what is modern-day Iraq.

Society

Saudi Arabia was, and is still in many respects in 2013, a tribal society. Up to World War II, urban life and exposure to the outside world was

minimal, except in Jeddah, a city that had historically catered to the passage and needs of pilgrims who invariably came from countries that were more developed than Saudi Arabia. The country, with a population estimated at around two and a half million in 1932 and an area of 1,546,000 square kilometers, was mostly desert and of no vital importance to the outside world, except to Muslim pilgrims. The roaming tribes could not afford more than bare subsistence, which was "made possible by the scatter oases, and the fatalistic acceptance of the existing order, based on strong religious precepts."[62] Saudi society was static, shaped by the underlying religious authorities in the country who viewed everything modern, from technological tools to communication services, as anti-Islamic. This tribal and nomadic lifestyle dominated, providing an extreme contrast to the American oil companies that would come to develop the country's vast oil resources.

Prior to oil, "the only source of income was the pilgrimage tax levied on the devout Muslims of the world [who] came to the holy city of Mecca to perform the annual Hajj; the population was overwhelmingly illiterate, very few indeed even of the royal family could read and write, and fewer were acquainted with and were aware of the world around them."[63] However, since the government was unable to meet the basic needs of the people and was in desperate need of revenues, it was willing to invite the foreign "infidels" to come and exploit the country's resources.

As foreign companies came to Arabia, the gap between the different economic strata only widened and the poverty of the natives was underscored. "The American oil companies came with their twentieth-century technology [that was enough to bewilder them]...and when the Company began to recruit labor from among the natives it took patience and perseverance to impress them with the desirability of steady, uninterrupted, disciplined work."[64] For the nomadic Arabs, it was a new concept to settle down and work in one place for long periods of time.

Economy

Essentially, at the time of the creation of the Kingdom of Saudi Arabia, the country was among the poorest countries in the world. Before oil, the overall basis of economic livelihood was subsistence agriculture, with pilgrims providing the only source of revenue. In large part because of the harsh climate and poverty, conquerors and empires had little interest in what is today's Saudi Arabia, with the

exception of the western region and the cities of Mecca and Medina. The state "operated within strict financial constraints and considerable resource poverty, with little distinction between royal and state resources as the state initially appeared little more than an extension of the ruling family."[65] The state was composed of several distinct regions. In the west, the population was dependent on subsistence agriculture, trade, and the business of pilgrims; in the eastern province was a plantation economy, with date farming and other cash crops; and in the center, marginal and subsistence agriculture and animal husbandry prevailed. Every area of the country was constrained by a hostile environment, due to the lack of drinkable water all forms of life were difficult, and the geographic features of the land separated the people and prevented extensive travel and cross fertilization. Oil was to change everything.

The United Arab Emirates (UAE)

Government and Politics

The rise of the British naval power in the Persian Gulf in the mid-eighteenth century coincided with the rise of two important tribal confederations along the coast of the lower Persian Gulf: the Quwasim and the Bani Yas, the ancestors of the rulers of four of the seven emirates that make up the UAE (Abu Dhabi, Ajman, Dubai, Fujairah, Ras al-Khaimah, Sharjah, and Umm al-Quwain, merged into a federal monarchy in 1971) in 2012. The locations of the UAE sheikhdoms on the Persian Gulf coast attracted British curiosity, because of British interest in securing as many communities as possible in the region to protect trade routes to India. In 1853, Britain formalized the Perpetual Maritime Truce, an agreement with the sheikhdoms of the lower Persian Gulf to maintain the de facto protectorate status of these sheikhdoms under the British Empire well into the twentieth century.[66] Later, in 1892, the Sheikh of Abu Dhabi signed an exclusive agreement with Britain that "established and steadily increased the role of Britain as the protector and controller of Abu Dhabi's government and affairs."[67] This agreement was part of a series of agreements that limited the rights of all emirate sheikhs to engage in independent relations with foreign powers and created the area known as the "Trucial States."[68]

Over the next 50 years, the sheikhdoms became part of the informal protectorate in the region. In the late nineteenth and early twentieth centuries, Dubai was little more than a fishing and pearl diving strategic base; however, over time, the sheikhdom established a ruling

dynasty and a relationship with Britain that helped in "increasing reliance on imperial support for security guarantees and, eventually,...economic wellbeing."[69] Early on, the sheikhdom experienced a great deal of internal turbulence. Opposition against the ruling dynasty was continuous, starting first with "merchants attempting to initiate autonomous development and reduce dependency on imperial networks, and then more seriously from reformers intent on limiting monarchical power and destabilising what was increasingly perceived to be a British sponsored regime."[70] The arrival of the British was a positive event for Dubai, because the emirate was able to develop a relationship with the imperial power to relieve it from competitive tribal pressure over its territory.[71]

After World War I, as the interest of the foreign powers in the oil resources of the region grew, the sheikh signed an agreement with the British on May 3, 1922 in which "he obligated himself to grant oil concessions only [to] a person appointed by the British government."[72] In return, the British granted all the emirates protection. This protection was particularly beneficial to the sheikhdoms that were facing regional threats and tensions, especially from Saudi Arabia. With the rising importance of oil, Abu Dhabi's ill-defined boundaries with Saudi Arabia became a territorial issue. As relations between Abu Dhabi, Great Britain, and Saudi Arabia became strained over these claims, the British rushed to protect the emirate, which feared a hostile takeover from Saudi Arabia.

Society

The social and cultural history of the UAE resembles that of the neighboring Arab countries. Prior to the discovery of oil and emerging as one of the great oil producers, Abu Dhabi was "a backward sheikhdom of the Trucial Coast (alternatively called the 'pirate coast' by some) with a sparse population in ill defined boundaries under a close relationship with Great Britain."[73] With a population of only 16 thousand living in dessert terrain, the country was both politically and economically weak, having very little influence on the affairs of the Persian Gulf. The inhabitants of today's UAE were relatively poor and unskilled when oil was discovered, as they had been mainly oriented toward the sea and sea activities. The history of the UAE's inhabitants dates back to the third millennium BC, with inhabitants leading the lifestyle of nomadic Bedouin tribes, with economic opportunities limited to fishing villages and date farms; this continued well into the early twentieth century. These resourceful desert dwellers adapted to

the environment by moving from pearling and fishing at sea on to herding and grazing in the desert, and further on to the oasis, where they engaged in the farming of dates and vegetables because they now had access to water sources and irrigation.[74] Each area of the country had a separate subculture, but all were economically, politically, and socially interdependent. Facing economic hardships, a number of residents of the Trucial States migrated to the southern provinces of Iran in search of a better life.

Economy

Prior to the production of oil, the UAE was poor and underdeveloped. Dubai's strategic pearl reserves attracted the attention of the British, but Britain took control of the economic activities of the sheikhdom and created a system of dependency, which ultimately took a toll on Dubai's economic freedom and prosperity. At the turn of the twentieth century, the UAE consisted of little more than several hundred palm huts, a few buildings, and the ruler's fort. Abu Dhabi, today's economic powerhouse, was the poorest emirate, while Sharjah enjoyed more power and had a larger population. Dubai, on the other hand, which had been a major trading hub between the Strait of Hormuz and beyond, became poorer than it had ever been. Overall, the region remained a backwater for fishing, pearling, camel herding, and farming, but with revenue of about only $750,000 in 1908, the sheikhdoms were undoubtedly economically behind the other sheikhdoms and states in the Persian Gulf and remained poor until the 1960s.

As was the case in neighboring countries, the UAE had been dependent on pearling, fishing, commerce, and piracy of commerce in the Indian Ocean at the beginning of the twentieth century. Over 1,200 pearling boats operated out of the Trucial States, affording some employment to most of the able workforce during the peak seasons.[75] The rest of the population "tended to camels and date gardens in the intervening period, [moving] permanently to one of the coastal settlements, increasing, in particular, the size and importance of Abu Dhabi and Dubai."[76] However, as with the neighboring states, the UAE was not immune to the impact of the external events following World War I. The sheikhs of Abu Dhabi, Dubai, and Sharjah and their pearling industry–based economies suffered a heavy blow and extreme devastation due to the Great Depression and the changes in the pearling industry. With the collapse of pearl prices, the population faced significant hardship, with the loss of their largest export and primary source of income.[77] The sheikhdoms

remained under pressure, economically struggling for almost 20 years, until the oil concessions were granted and the sheikhdoms were able to use the income from oil to develop the physical and social infrastructure in the early 1960s.

Summary

Before the discovery of oil, oil exports, and the flow of oil revenues in the countries of the Persian Gulf, the entire area could have been considered poor. These countries and sheikdoms were, like most other underdeveloped countries, ripe for exploitation by the imperial powers. The sheikdoms relied on pearling and fishing for revenue, and Saudi Arabia was dependent on the expenditure of pilgrims to Mecca and Medina. Iran, though technically not a colony, was treated as such by Russia and Great Britain up to 1917. After World War I, Great Britain, sensing a Russian move into Iran, even contemplated making Iran a protectorate. But Iran was in a somewhat different league politically, socially, and economically compared to the other countries. First, and foremost, Iran, unlike all the neighboring countries or sheikhdoms, had been an independent country for centuries and had not been colonized. Iran was the first country in all of Asia to have a constitutional revolution (and the second in the Middle East—after Turkey in 1876—to have a constitution) in its quest for a more democratic and independent system of governance with a parliament. Before the beginning of the twentieth century and the unsettling practices and policies of the late Qajar shahs, Iran had a middle level of per capita income. Although largely mountainous with desert terrain, Iran was blessed with productive agricultural land and plenty of water, affording the inhabitants the opportunities of economic diversity. The Iranian gentry were more educated than the tribal leaders in neighboring lands. The rise of Reza Khan in 1921 and his ascension to the throne in 1925 allowed Iran to remain independent.

The Iraq that was created in the twentieth century, although not an independent nation state as Iran had been for centuries, had its own long history as Mesopotamia. However, the specifics of its demarcation in the twentieth century guaranteed that sectarian and ethnic divides would plague its very existence and viability as a nation state. It had agricultural production with great potential, but as a newly created state Iraq had few if any institutions. All the other countries in the Persian Gulf were new creations. The Al-Sauds conquered all the other tribes to create Saudi Arabia, a country with no economy or revenues to speak of.

Before the discovery and growing importance of oil, the countries of the Persian Gulf were poor and of limited interest to foreigners, although the sheikhs in the region courted the British for support against more powerful neighbors. The interest of foreign powers, principally Great Britain and Russia, in Iran was strategic. For Russia, Iran afforded access to the warm waters of the Persian Gulf and trade routes. For Great Britain, Iran allowed for control of the Persian Gulf as a way to safeguard Britain's important colonies, principally India, and to protect its global trade routes. The other countries of the Persian Gulf held little or no interest for Russia, but the Trucial States, especially Qatar and Bahrain, were considered useful by Great Britain as alternative (to Iranian) bases of operation in the lower Persian Gulf. From the outset, the great powers interfered in all aspects of development of the countries in the Persian Gulf, with their own selfish interests as their compass.

As we will see, oil changed all previous and then existing calculations. The Persian Gulf took on global economic importance in its own right. Much later in the twentieth century, the United States entered the fray, European powers expanded their presence, and Russia and more recently China had to safeguard their economic interests. The countries in the Persian Gulf and the Persian Gulf itself became critical to the world. The interference of so many foreign powers changed the political, social, and economic developments of all these countries and the face of region as a whole. Oil changed the history of the world.

At the same time, the countries of the GCC (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE) undoubtedly would not have been transformed (not necessarily developed) economically without the inflow of vast oil revenues. Before oil they were poor. Vast oil revenues gave them the means to change their economic landscape. Without oil, they most likely would be poor today, without the trappings of a modern state. Ironically, Iran and Iraq, on the other hand, might arguably have fared better if oil had not been discovered in the region, because they had other options for development that might have proved more productive over the longer term.

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Chapter 2

Oil—Discovery and Production in the Persian Gulf (1900–1945)

A hundred or so years ago, at the turn of the century, oil was not a critical input for the global economy and even less so for the economic and political affairs of the Persian Gulf and the greater Middle East. To state the obvious, oil became an inseparable part of the Middle East region's fabric as it rose to global importance as a commodity, and the region became a significant supplier of oil to world markets, with oil revenues contributing a large share of the region's total export revenues. During the twentieth century, the global importance of oil increased as oil became an important fuel for transportation, a use where it had little competition. Oil replaced coal in boilers of ships and in locomotives of trains, was used to power the first automobiles, and then fueled airplanes, powered industrial furnaces, provided electricity, and even heated homes and commercial buildings. While oil had little competition in powering automobiles and airplanes, its primary competitor in other uses was coal, a fuel that is dirty and more costly to transport, and to a lesser extent natural gas, the cleanest of the hydrocarbon fuels, which became steadily easier to transport to markets and thus became a growing competitor to oil. Although there was competition from other fuels—coal, natural gas, hydropower, nuclear, and renewables—the share of oil in global primary energy consumption continued to increase, especially after World War II. In 2012, the share of oil in global primary energy consumption stood at 34 percent, followed by coal (29 percent), natural gas (24 percent), hydroelectricity (10 percent), nuclear (5 percent), and renewables (1 percent).[1] There are, however, major regional differences in the pattern of energy consumption. There is an expectation that shale gas, oil from shale and tar sands, and to a lesser extent

renewables, may become more important at the expense of coal and nuclear fuel because of environmental and safety concerns, higher crude oil prices, and the discoveries of large shale gas deposits around the world.[2]

In this chapter and the following three chapters, we look into when and who discovered oil and produced it in the Persian Gulf, how oil became the critical input for the global economy, why the Organization of Oil Exporting Countries (OPEC) came to be, how the oil exporters wrestled control of the oil business from the major international oil companies and their home governments, the context and evolution of oil prices, how these developments affected the political economy of the region along the way, and how relations between oil companies and the Persian Gulf countries shaped relations with the European powers, the United States, and the outside world.

The Discovery of Oil

Oil was discovered in the Persian Gulf roughly one hundred years ago. For the first 60 years after this momentous discovery, it was foreigners who found, produced, and transported Persian Gulf oil. Foreign control of Persian Gulf oil resources lasted well into the 1960s and early 1970s. And as expected, foreign companies, with political and military support of their home governments, exploited the oil wealth of the Persian Gulf countries primarily for their own gain and at the expense of the indigenous population. In the early days, companies from Great Britain, and later those in the United States, France, and Italy exploited the region's oil using the threat of military intervention and political and economic boycott. In every country in the Persian Gulf, foreigners dealt with dictators—kings, sheiks, or presidents—to gain access, explore, find, and produce oil. Their home governments aggressively supported the companies, as imperialists and colonialists would be expected to do. Corrupt practices were part of their dealings with absolute rulers and their cronies. And, at least at the outset, the citizenry in the Persian Gulf received little or no direct benefit from the discovery of oil, its production, and export, because the major beneficiaries were those in power in the Persian Gulf. The oil companies were in no way concerned with the welfare of the general population. In this chapter, we take a brief look at the early years of oil production, around the time when oil was first discovered in Iran, Iraq, Bahrain, Saudi Arabia, Kuwait, the UAE, Oman, and Qatar.

Iran (Persia)

In the early 1890s, the findings of a French government mission headed by Jacques de Morgan indicated promising petroleum-containing structures in Persia (as the country was commonly referred to at that time). Because of hostile political and economic conditions, the French did not follow up on their find. Instead, it was left to the British, who secured Persia's oil concession for the adventurer William Knox D'Arcy. Despite the "decay in the central authority, social unrest, corruption of the administration, mortgaged national resources, foreign political interference and arbitrary rule of ignorant leaders, the D'Arcy concession was granted on May 28, 1901—aided by the personal efforts of the British Minister in Tehran."[3] According to the British Minister, "the agent of D'Arcy's mission deserved support as it was to win the goodwill of the Persian government by assigning shares in the proposed development of the rich oilfields believed to exist in Western Persia to some of its most influential Ministers."[4] Antoine Ketabji Khan, the director general of the Persian Customs, received a £1,000 annual salary from the concessionaire that started even before his appointment as Persia's Imperial Commissioner, and his three sons were also recruited with handsome salaries, with all of the Ketabji family receiving shares in the exploration company.[5] Because of widespread corruption among Persia's ruling class, there was little choice for the foreigners but to follow the then-prevailing corrupt channels to secure concessions. The British government gave D'Arcy its official and extensive support, including military protection for the company and its employees, from December 17, 1907 to September 25, 1909.[6]

The terms of the concession afforded D'Arcy the exclusive privilege of exploiting all hydrocarbon resources in Persia—excluding the five northern provinces (an area of roughly 500,000 square miles)—for a period of 60 years, beginning on May 28, 1901.[7] In return, Persia (effectively the shah) received £20,000, and Iran was given shares in D'Arcy's company and promised 16 percent of all future profits. The decision to link payments to the Persian government to profits was designed to "provid[e] the concessionaire with a degree of protection if little or no profit, or even a loss, was forthcoming in certain years."[8] If there were losses in a given year, the company was not required to pay the Persian government anything. Additionally and importantly for the foreign company, the interest of the Persian government was linked to D'Arcy's success.

Revenue payments as a percentage of net profits appeared attractive to the Persian government, because the government believed that

the company would prosper in each and every year (something that did not turn out to be the case). Payments under this method were subject to fluctuations and were in fact contrary to the government's interest for a steady flow of revenues to overcome budgetary difficulties. In addition to the exemption of fixed and unconditional royalty payments, D'Arcy obtained a number of other concessions from the Persian government, and most importantly the sole or exclusive right to lay pipelines in the concession area (something that was to have important economic benefits in the future)—cementing the concessionaire's right to be the sole prospector for oil over the huge territory, and blocking Persia's ability to give concessions to other companies in northern Persia, because they would need pipeline access to the Persian Gulf, thereby insulating D'Arcy from all future competition to also become concessionaire of northern Persia.[9]

Drilling began at Chia Surkh in western Iran in 1902. Oil was found in 1903 and 1904, but not in commercial quantities. Drilling moved to the Bakhtiari-inhabited territory in the southwest region of Iran in 1905; the British company compensated the semiautonomous Bakhtiari tribesmen for exploration and grazing rights, with a 3-percent ownership interest in all companies established to exploit oil resources in their district, plus £3,000 annually beginning in 1905 for safeguarding the company's property and pipelines. After a four-year search for oil, D'Arcy's private funds were strained and on May 20, 1905, the Concession Syndicate was established to take over the D'Arcy concession.[10]

On May 26, 1908, oil was found in commercial quantities at Masjed-e-Suleiman in southwestern Persia or Iran. On April 15, 1909, the Anglo-Persian Oil Company (APOC) was formed to take over D'Arcy's concession. At that time, the Burmah Oil Company became APOC's largest stockholder, with an initial capital of £2 million. In 1913, the huge Abadan refinery came on line to refine Persian oil, in time becoming the largest "single" or "integrated" refinery in the world. Given APOC's need for additional capital, the British government took a 56-percent controlling interest in the company in 1914, with the infusion of an additional £2.2 million in capital. Burmah Oil was left with 26.5 percent of the common shares. In time, APOC, with the backing of the British government, questioned provisions in the concessionary agreement made between D'Arcy and the Persian government, namely, the right of the Persian government to share in the profits of all subsidiary firms. In 1920, after the collapse of Czarist Russia, the ascendancy of British influence over Iran and the treaty of 1919, the Armitage-Smith (named after the

British Treasury official) negotiations (on behalf of APOC) with the Persian government resulted in "extensive variations from the original D'Arcy concession to the detriment of the host country."[11] The British authorities simply, and unilaterally, terminated four important rights of the Persian government:

(a) Profits of the British Tanker Company, a fully owned subsidiary of APOC, were excluded in all future years from royalty payments to Persia.
(b) Profits of other subsidiaries were also excluded from royalty payments to the extent that their trading involved non-Persian oil.
(c) Profits of subsidiaries refining or marketing Persian oil outside Persia were eligible for sizeable deductions before computing royalty payments.
(d) Subsidiaries were restrictively defined to include only those in which APOC had a majority interest.[12]

Thus, by unilaterally limiting the government's share almost exclusively to profits from oil production in Persia, APOC was able to divest the company of its subsidiaries and limit its activities to selling Persian crude oil on a free on-board basis at the Abadan loading terminal. Such actions were unlikely to endear the British and British oil companies to the Persian people, but this seemed to be of little concern to the companies or, even more importantly, to their home countries, that might have been expected to have a more long-term view of relations. High-handed actions would in all likelihood lead to long-lasting resentment and backlash in the future and would shape the Persian-British relationship. But Persia had little choice because it lacked the technology and capital to go it alone, important foreigners controlled the global oil market, and there was always the threat of imperial force.

Simultaneously, APOC had invested in ventures in other areas of Persia and even outside of Persia—such as in Iraq (more on Iraqi oil development below)—with little visible local benefit. As a result, by the early 1920s, there was widespread resentment of the British and of APOC's role in Iran. The dispute with APOC was centered on a number of issues: access to APOC's books to assess profits and other operational numbers (information that is invariably available to any stockholder), a 25-percent ownership in APOC (including in subsidiaries that had been annulled), a higher dividend rate, the lifting of the royalty rate on oil, the ability to impose higher taxes on profits, an end to APOC's exclusive right to transport Iranian oil, and the area of APOC's Persian concession. Negotiations made little progress, and by the early 1930s annual

Persian royalties were slashed to under £500,000, in part because of the global economic slowdown and a global oil glut. In 1932, after having taken over the throne and becoming Reza Shah (1925), Colonel Reza Khan cancelled the original D'Arcy concession. In 1933 he signed a new 60-year concession agreement that looked much better on paper but again shortchanged Persia and the Persian people. Persian resentment continued to grow as APOC exploited the country—for example, giving Persia only 15–20 percent of its after-tax profits after World War II and into the early 1950s—and employed Persians in what could only be described as atrocious working conditions.

Looking back at the development of APOC, later renamed the Anglo-Iranian Oil Company (AIOC), it began modestly with an authorized capital of £2 million, in part as payment for the concession (£1,380,249).[13] Within two years of its formation, the company had impressive growth in oil output and had pipelines and refining capabilities. When the British government became a major partner in the company, the authorized capital increased, and at the end of 1915 profits were £63,720.[14] Over the next three decades, reported profits increased, new oil fields were added, the number of pipelines increased, and facilities of the refinery at Abadan expanded, allowing for handsome profits, even after the 1929 crash. By the end of 1950, the last full year of operation before the attempted nationalization, the AIOC saw trading profits of £84,466,342 and net profits of £33,102,572. Production of crude oil was at an all-time high of 31,750,000 tons, with the Abadan refinery processing 24,059,000 tons of crude.[15] But Iran's share was a small fraction of the company's profits, and because of widespread corruption among the Iranian elite the Iranian people's benefits were even less significant. Such a state of affairs could only lead to popular, ingrained, and prolonged resentment against rulers and foreigners who exploited the people.

In over 40 years of oil production, the AIOC had paid the government of Iran only £150,000,000 in royalties, while its reported trading profits in one year alone, 1950, were £84,466,342, with additional profits from its many subsidiaries. Such uneven sharing of profits was bound to cause increasing conflict between Iranians and the foreigners as well as resentment toward their compliant shah and his government. In fairness we should add that the company had also invested in projects across the country that supported its oil operations (expenses that were subtracted to arrive at reported profits). Abadan was transformed from a "waste-uninhabited island . . . to a modern city with a 24 million-ton capacity."[16] As the company grew, so too did various aspects of oil production outside the country, from exploitation

to distribution, and marketing facilities with interests extended to a number of foreign companies, such as the Iraq Petroleum Company (IPC) and the Kuwait Oil Company (KOC).

In those early days, the impact of oil production on the people of Iran was limited while expectations were increasing. But oil revenues still left a mark. The royalty income and other payments, though a small fraction of the AIOC's total income, played a role in the life of a country with limited foreign exchange earnings and "created a dependence . . . which affected the entire financial structure of Iran."[17] The company created jobs, directly and indirectly, an estimated total of 70,000 by 1950, but still its direct influence on the Iranian population was limited. Although the oil industry did create jobs for Iranians, it employed "a relatively small fraction of the [entire] labor force, far out of proportion to the wealth produced."[18] The modest social services, benefits, and income enjoyed by Iranian employees of the company were not felt by the rest of the population, and while the revenues supported the government's budget and lined the pockets of the ruler and government officials, the population at large, especially poor peasants, remained as backward as ever. Moreover, the income of the oil industry, as well as the various social services it supplied to its employees, for example, schools, clinics, and hospitals, also created discontent among the broader population at large.

While foreigners, in particular a foreign oil company, could not be expected to protect the interests of the Iranian people, the government of Iran should have done so. But Iranian officials acted in their own personal interests, a fact that was quite apparent to the average citizen as well as to foreigners in their negotiations with officials. Foreign governments used all manner of pressure and threat of force to support their companies, shareholders, and their own national treasuries. Iranians felt that the profits rightfully belonged to Iran and that such profits could alleviate all their difficulties, fueling resentment toward foreign exploitation of Iranian oil, a resentment that has lived on for generations.

Iraq

In 1904, Iraq (then called Mesopotamia and a part of the Ottoman Empire, which became a monarchy in 1921 and gained independence from Britain in 1932) signed a contract with the Anatolian Railway Company—acting for the Deutsche Bank—to carry out a preliminary survey of the fields in Baghdad and Mosul. After two years, Iraq ended negotiations with the Anatolian Railway Company and initiated negotiations with the same William Knox D'Arcy who had

earlier secured the lucrative concession in Iran and at this time had the active support of the British Ambassador at Constantinople.

Oil activity in Iraq started in 1912 under a newly formed company, the Turkish Petroleum Company (TPC). By 1914, the APOC had become TPC's largest shareholder with a 50-percent ownership. But with the onset of World War I, no significant activity was to take place for a while. In 1927, oil was struck in commercial quantities near Kirkuk. As a result, in 1928 it became urgent to reach a formal agreement that afforded shares of TPC (renamed the IPC in 1929) to British, American, and French interests. Two additional concessions were granted to affiliates of the IPC: Mosul Petroleum Company (MPC) obtained a 75-year concession in 1932, and Basra Petroleum Company (BPC) was awarded another 75-year concession in December 1938.[19] This concession covered all lands not included under previous concessions (about 93,000 square miles); except that BPC was to pay a rent of £200,000 annually until commercial quantities were exported, all other provisions of the agreement were the same as those for MPC. BPC began producing and exporting oil in 1951.[20] British Petroleum (BP), Shell Petroleum, Compagnie Française des Pétroles (CFP), and Near Eastern Development Corporation owned the three companies in equal shares of 23.75 percent; Participation and Exploration Company owned the remaining 5 percent.[21]

Foreigners assumed total effective control of Iraqi oil, while promising Iraq additional future royalties and loans. Although oil in commercial quantities was discovered as early as 1927, it was not until 1934, with the completion of the company's pipeline, that significant quantities of oil were produced and transported. In Iraq, the operating companies that produced the crude oil were owned jointly by two or more of the following eight international oil companies: Exxon, Shell, BP, Mobil, Texaco, Gulf Oil Corporation (Gulf), Standard Oil of California (Chevron), and CFP.[22] In different combinations, a number or all of the oil companies owned 95 percent of all operating companies in Iraq. Oil was produced by IPC and its affiliates on behalf of its shareholders (prior to the 1972 nationalization measures). The shareholders jointly determined the volume of output. In 1927, the first year of discovery, Iraqi oil production was 45,000 metric tons. In 1928, production more than doubled to 95,000 metric tons and continued to increase up to 8,351,000 metric tons in 1951.[23] But with the global economic slowdown and an oil glut in world markets, significant Iraqi oil exports did not reach world markets until just before World War II. And as in Iran, the right and power to determine output and prices were vested in the concession holders, as opposed to the government of the country where oil reserves were found, which was a passive recipient of oil revenues.

Still it would appear that the British-installed monarchy (after World War I in 1921) in Iraq got along relatively well with IPC, and negotiations for more favorable profit-sharing arrangements and higher levels of oil output were on the whole friendly and reflected terms that were similar to those afforded to Saudi Arabia.

Bahrain

The discovery of oil in Bahrain was a key event in that it proved to competing Western interests that there was an abundance of oil in this area of the Persian Gulf, fueling the demand for concessions by a number of other oil companies, especially for exploration in Saudi Arabia. In 1925, Bahrain captured the interest of the American Gulf Oil Company (GOC). In November 1927, the GOC took over the rights claimed by Eastern and General Syndicate to Arabian concessions, but owing to the terms of the Red Line Agreement, with GOC a signatory when it became part of the TPC in 1928, it could not act independently on its concession in Bahrain.[24] In 1929, GOC was required to sell its rights to the Standard Oil Company of California (SoCal), another company interested in expanding its foreign oil activities. SoCal proceeded to set up a Canadian subsidiary, the Bahrain Petroleum Company (BAPCO), to acquire an oil exploration and production concession in Bahrain.

While SoCal was not subject to the terms of the Red Line Agreement and could begin to engage in oil operations in Bahrain, another challenge soon emerged, this time from the British. The British were opposed to SoCal's activities in Bahrain, and to protect their interests in the face of the rising interest by foreign (namely American) companies in the region, they "made agreements with the local sheikhs, including those of Kuwait and Bahrain, that oil development should be entrusted only to British concerns, and that the British government would be in charge of their foreign relations."[25] According to these agreements, Britain called for a "British nationality clause" to be included in every concession agreement, which meant that any oil activities had to be carried out by British interests only.[26] It held this position throughout two long years of negotiations, until it made an agreement in 1929 with SoCal that allowed the company to engage in oil activities in Bahrain as long as Britain was guaranteed "political primacy" and that "all communications from the company to the Amir were to pass through the political agent, the local representative of the British government."[27]

In October 1931, BAPCO began drilling, and the first modest oil discovery was made on May 31, 1932 in southern Bahrain.[28] Three years later, in 1935, the first shipment was exported from Sitrah. By

the end of 1935, Bahrain had 16 oil wells in production, with crude oil providing the government royalty payments that accounted for more than 40 percent of the state budget.[29] However, it is important to note that SoCal was facing production challenges in Bahrain. Despite a potential production capacity of 30,000 barrels per day, actual production was 13,000 barrels per day. SoCal was struggling to sell directly to European refiners because they could not readily handle Bahrain's high sulfur crude.[30] As a result, in the beginning of 1935, SoCal "choked down its production in Bahrain to just 2,500 barrels per day due to lack of access to markets."[31] BAPCO's production activities generated about 60 percent of the government's income and played a major role in financing development projects in Bahrain, from health care to education. In 1952, the government of Bahrain signed a participation agreement with BAPCO, marking the beginning of the alliance between the government and national oil company and the beginning of greater government involvement in oil activities. Later in 1974, the Bahraini government established the Bahrain National Oil Company (BANOCO), which acquired a 60-percent stake in BAPCO.[32] By 1980, the government had gained total control of all petroleum operations.

In comparison to global oil production and to other producers in the Persian Gulf, Bahrain's oil reserves and production were small. Due to dwindling oil supplies, activities lasted only till around 1995. In the first 30 years of oil production, between 1935 and 1965, about 50 percent of the country's oil resources had been depleted. Since the discovery of oil in southern Bahrain in 1932, production quantities have varied, passing through periods of increase and decline. A single onshore oil field was discovered (Awali in 1935), and from the time of its discovery to 1976, crude oil production was on a steady upward direction. As early as 1932, Bahrain's wells produced 84 barrels per day.[33] By 1940, the average output per day had risen to 19,380 barrels.[34] In 1974, annual oil production was up to 24.6 million barrels, with total reserves in the Awali field estimated at 300 million barrels.[35] By 1977, production reached its peak of about 77,000 barrels per day. Despite the upward trend lasting for almost 30 years, oil production in Bahrain has been fairly low—all in all, since the 1930s, the cumulative production in Bahrain is about 900 million barrels.[36] By 1980, Bahrain's oil production was slowing down due to dwindling reserves, and was down to about 57,000 barrels per day. Between 1980 and 2008, oil production in Bahrain has averaged around 50,000 barrels a day, falling to a steady 48,000 barrels per day between 2005 and 2008.[37]

In addition to the Awali oil field, the offshore field of Abu Safah, which Bahrain shares with Saudi Arabia, has played an important role in the country's oil industry and economic development. In 1963 Saudi Aramco discovered Abu Safah. Three years after Abu Safah's discovery, production began in 1966, but owing to the field's location, the two countries decided to negotiate a production-sharing agreement. According to the agreement, Aramco would be given control over all operations—which it still controls in 2013—while Bahrain would receive 50 percent of the revenues from the Saudi government. Based on the terms of the 1972 agreement, as soon as the oil leaves the Saudi port of Ras Tanura, BAPCO collects the money.[38] This agreement has been highly beneficial to Bahrain, because it receives 50 percent of the revenues from Abu Safah, without incurring any production costs. But regardless of the initial terms of the revenue-sharing agreement, the revenue Bahrain receives from Saudi Arabia has varied with production levels throughout the years. In the first decade of operations at Abu Safah, production was about 44 million barrels, with almost half of Bahrain's oil revenues coming from Abu Safah. However, because of declining oil prices from 1987 to 1992, Bahrain received an additional 7,000 barrels per day of crude in compensation from Saudi Arabia.[39] When production at Abu Safah picked up again in 1992, Bahrain was once again given 50 percent of revenues, a percentage that then increased to 100 percent between 1996 and 2004. In 2004, revenue receipt was brought back down to 50 percent. In 2012, the revenue from Abu Safah was the single largest source of income for Bahrain. Saudi Arabia's unquestioned generosity has been motivated by two considerations—Bahrain's proximity to Saudi Arabia and the Al-Saud's fear of Bahrain's Shia majority.

Saudi Arabia

In 1923 Abdulaziz Al-Saud, before uniting a number of powerful tribes that controlled different regions of what is today's Saudi Arabia and proclaiming himself king, granted a concession to Major Frank Holmes, a mining engineer from New Zealand. However, the syndicate Holmes represented was unsuccessful in persuading any oil company to take the risk of looking for oil in the country. The Holmes concession, which covered more than 77,000 square kilometers in what is today eastern Saudi Arabia, lapsed through expiration. But after oil was discovered in Bahrain in 1932, a number of companies expressed renewed interest in Saudi Arabia. SoCal, today's Chevron, was particularly interested in exploration rights. After overcoming all his adversaries, Abdulaziz Al-Saud founded the Kingdom of Saudi Arabia in 1932,

and in 1933, desperate for revenues, Saudi Arabia signed a concession agreement for the eastern sector of the country with SoCal.

On May 29, 1933, the Minister of Finance of Saudi Arabia and a lawyer from SoCal signed the agreement in Jeddah, giving SoCal oil exploration, drilling, extraction, and exportation rights. In the concession agreement, SoCal committed itself to loans totaling £50,000 pounds in gold, yearly rentals of £5,000, and royalties of four shillings per ton of oil produced. SoCal also undertook to provide the government an advance of £50,000 in gold once oil was found in commercial quantities. Desperate for revenues, King Abdulaziz was in favor of immediate exploration and drilling, and for construction of a refinery after oil was discovered and produced.[40]

In July 1933, two American geologists landed at the village of Jubail on the east coast of Saudi Arabia and launched a five-year search for oil. On March 3, 1938, oil in commercial quantities was discovered in Dammam in what is now called the Arab Formation.[41] At the time before oil revenues started flowing, government revenues were only about $7 million, 50 percent from customs with most of the rest from Muslim pilgrims, and with a meager $267,000 from oil royalties.[42] Full-scale development of oil fields began in 1941. From this point on, development was rapid. Six months later a pipeline was laid from Dammam to Al-Khobar, and in the same year, Ras Tanura was selected "as the terminal site of a 39-mile pipeline where tankers were to be loaded."[43] The success of the undertaking attracted more concession seekers from German and Italian companies, as well as from the IPC and the California-Arabian Standard. On May 31, 1939, W. J. Lenahan, representing SoCal, signed a supplemental agreement that "extended the original area by 80,000 square miles, to make a total of 440,000 square miles; this new area covered the neutral zones between Saudi Arabia and Kuwait and between Saudi Arabia and Iraq."[44] In 1940 daily production in Dammam reached 30,000 barrels. In March of 1940, the Abu Hadriya field was discovered, followed by Abqaiq, which was producing 590,000 barrels a day by 1951; Qatif and Ain Dar were discovered in June 1945, with production capacities of 20,000 and 150,000 barrels, respectively. Other fields continued to be discovered after the war.

King Abdulaziz's choice of an American oil company was at the time bold, because the United States had no prior involvement in Saudi Arabia and was a neophyte in the region. Britain had been the historical "meddler," or colonial power, in the Arabian Peninsula. However, Abdulaziz did not trust the British because they had backed the Hashemites—who he had forced out of Mecca in the 1920s—to become the rulers of Iraq and Jordan. Abdulaziz feared an assault

from the Hashemites, with British support.[45] Although the British had offered their backing, the cunning Abdulaziz believed that the United States afforded him, his family, and his kingdom better protection and leverage as a foreign power. It should be emphasized that in the case of Saudi Arabia, oil concessions and development went hand-in-hand with a US commitment to protect the newly established Al-Saud rule over all of Arabia. Theirs was not, and is not even in 2013, a straightforward business transaction. It is business and politics wrapped tightly together. Abdulaziz gave the oil concession to an American company in return for revenues and protection, and the United States built an airbase in eastern Saudi Arabia to show its commitment. Although SoCal had found oil in commercial quantities in 1938, with the onset of World War II oil production and exports went on a slow track.

In 1943, during the course of the first "modern war," the US administration became fully aware of the future economic and national security importance of oil. President Roosevelt, recognizing oil's growing importance and the likely role of Middle East oil, declared: "the defense of Saudi Arabia is vital to the defense of the United States."[46] As Ottoway notes, "[this] must have surprised the many Americans who had never even heard of Saudi Arabia." As stated above, this was at the foundation of the relationship between the United States and the newly established kingdom of Saudi Arabia—exclusive US access to Saudi oil in return for protection of the Al-Sauds. As an aside, during the Arab oil embargo of the United States from 1973 to 1974, Abdulaziz's son, King Faisal of Saudi Arabia, still secretly gave the United States oil for the war effort in Vietnam, in recognition of this long-standing commitment. President Roosevelt and King Abdulaziz cemented their relationship in 1945 aboard the USS Quincy. Earlier, in 1944, the California Arabian Standard Oil Company was renamed the Arabian American Oil Company, or Aramco, and three other American oil companies—Exxon, Mobil, and Texaco—joined SoCal as equal partners. It was truly an all-encompassing American-Saudi deal: political and military support for the family rulers in exchange for access to oil.

Beginning in 1933, Aramco's Saudi Arabia venture developed into one of the world's largest oil undertakings. Aramco laid down a pipeline network and the refinery at Ras Tanura was expanded to a 50,000-barrel daily capacity.[47] To grow with the support of the Saudi government, Aramco hired more and more local labor. Aramco also introduced Western-style housing and living for its expatriate staff, leading to Western-type towns springing up on the eastern coast of Saudi Arabia near the oil fields and refinery.[48] They also built hospitals, clinics, and health centers in the refinery location. The American

oil companies displayed more sensitivity and a "softer touch" than their British rivals, something that would serve them and the United States well in the future, blunting popular resentment.

Kuwait

As early as 1914, international oil companies recognized that there might be large quantities of oil in Kuwait, with great economic significance for Great Britain because Kuwait was a British protectorate. But the actual story of oil exploration in Kuwait "began in the early 1920s when Major Frank Holmes, representing the Eastern and General Syndicate, obtained a concession from the rulers of Kuwait and attempted to sell it to the Anglo-Persian Oil Company (APOC)."[49] When the APOC declined the offer, the Syndicate offered the concession to the Gulf Oil Corporation. On December 14, 1933, the Gulf Oil Corporation and APOC entered an agreement "which provided that they should exercise Eastern Gulf Oil Corporation's option on any concession which the Eastern and General Syndicate might obtain in Kuwait."[50] The agreement also provided that:

1. "Agencies and facilities at the disposal of each of the two companies should be used to obtain the concession on terms of more onerous to the concessionaries than those of a draft concession;
2. each party should share equally the expenses subsequently incurred by either one in obtaining the concession, including £36,000 which would be due Eastern and General Syndicate if Eastern Gulf should take up its option from the Syndicate; [and]
3. production was to be shared equally by the parent companies, and that ownership of one party was not to be sold or transferred except with the consent of the other."[51]

About one year later in 1934, the KOC, a British-registered company equally owned by BP and the US Gulf Oil Company, secured a 75-year concession.[52] The concession covered the entire territory of Kuwait proper, its islands, and coastal waters. The concession provided for a royalty of 3 Indian rupees per ton of crude oil produced, which at the time was the lowest royalty payment in the entire Persian Gulf area. In 1949, when the rupee was devalued, the royalty was equivalent to about 9 cents (US) per barrel of oil. After negotiations between the Sheikh of Kuwait and the company over the royalties concluded in 1951, it was announced on December 3 that a "50/50 profit-sharing arrangement had been worked out, effective as of December 1, 1951."[53] This new arrangement

required the company's earnings to be subject to a corporate income tax, in addition to the royalty previously paid. Accordingly, the royalty payments were 52 cents per barrel, and in return the concession was extended for an additional 17 years to a total of 92 years from 1934.

Although oil was discovered in Kuwait before World War II, its commercial development began only after the war in 1946, with KOC taking the lead. However, along with KOC, three other foreign companies operated in the Neutral Zone (the disputed area jointly administered by Kuwait and Saudi Arabia that lies between them) and the offshore areas: the American Independent Oil Company (Aminoil), which shared rights with the Getty Oil Company; the Japanese-owned Arabian Oil Company (AOC); and the Kuwait Shell Petroleum Development Company of the United Kingdom. In 1948, when Kuwait auctioned its concession rights in the Neutral Zone, Aminoil was the successful bidder, sharing the Neutral Zone equally with the Getty Oil Company, the winner of the concession for the Saudi Arabian rights. Accordingly, Aminoil was required to pay royalties and taxes to Kuwait, while Getty Oil was obligated to Saudi Arabia. In 1958, AOC was granted a concession from both Kuwait and Saudi Arabia. Kuwait was to receive at least 57 percent of the profit on crude production and on marketing without investing in the enterprise. Kuwait would be entitled to additional profits by "purchasing up to 10 per cent of the AOC shares at cost after oil is discovered."[54] In return, the company was to construct a refinery in Kuwait or in the Neutral Zone when production reached 150,000 barrels per day. And Kuwait Shell Petroleum Development Company of the United Kingdom was granted a concession in the portion of the Persian Gulf in the area of Kuwait proper on January 15, 1961.

In November 1949, KOC "completed a refinery at Mina al-Ahmadi, with a capacity of 1,000,000 tons annually, or 25,000 barrels per day; by the end of that year it had refined 118,000 tons."[55] The following year KOC refined 1,101,000 tons and provided gasoline and kerosene for the local market and the company's operation needs, as well as furnace and marine diesel oil for tankers including crude at Mina al Ahmadi. In 1944, Kuwait's reserves were estimated at 4 million barrels and by 1949 reached nearly 11 billion barrels; in 1954, this was raised to 28 billion, surpassing the level of Saudi Arabian reserves at that time. Since then, production has been concentrated in two fields: Burgan (the second largest field ever discovered after Saudi Arabia's Ghawar) since 1946 and Magwa since 1953.[56]

The oil industry naturally developed employment opportunities. In a short period of time, labor shifted away from pearling, fishing, and

boat building into the oil industry, and later into "government service, construction, and the manifold service occupations of a high-income economy."[57] As the oil industry expanded, labor-intensive industries shrank, expectedly aiding the shift of labor, simultaneously changing the entire economic structure of the sheikhdom and to some extent the social structure. The oil boom also offered more opportunities to foreigners in Kuwait. Along with these opportunities came higher wages, "supplemented by the free health, education, and other services of a welfare state."[58] Oil revenues—about 75–80 percent—were reinvested in town planning projects starting in 1949. This included new commercial buildings, apartment blocks, and government offices, as well hospitals, schools, mosques, public buildings, and the first power and water distillation plants.[59] By 1939, a Department of Education had been set up, as well as four schools, including a school for girls. As "the income from oil increased, the school system expanded, and education was equivalent to $7.5 million, making up 12 percent of the total budget."[60] In addition to the Department of Education, the Departments of Justice, Health, Development, Public Works and Finance were also established, allowing for a comprehensive development plan agreed upon by all ministries in the winter of 1952.[61] Through allotment of capital to different sectors, the city of Kuwait was rebuilt and entirely changed. However, this change was not only limited to the infrastructure of the city—the standards of health, education, sanitation, and general welfare also changed for the better. Consequently, by 1955 Kuwait was transformed from a backward state to the forefront of social development among countries of the Persian Gulf.

The UAE

Oil came on line in the UAE some time after it did in the four oil-producing giants: Saudi Arabia, Iran, Iraq, and Kuwait. One of the seven sheikhdoms that make up the UAE, Abu Dhabi, would in time also emerge as one of the oil-exporting giants in the world. First a bit of history: in 1892, an exclusive agreement was signed by the Sheikh of Abu Dhabi with Britain, establishing and increasing the role of Britain as the protector of the sheikhdom. With total government revenues of $750,000 in 1908, the sheikhdom was always in need of revenues. On May 3, 1922, the British signed an agreement with the Sheikh, in which he "obligated himself to grant oil concessions only to a person appointed by the British government."[62] At this point—when the potential of finding oil became a distinct possibility—the ambiguous and disregarded ill-defined boundaries between the sheikhdom and Saudi Arabia became a concern.

In 1949, the first exploratory well was drilled at Ras Sadr, about 50 kilometers from Abu Dhabi Island on the way to Dubai. After over a year of drilling with no success, another well was drilled at Murban, 100 kilometers southwest of Abu Dhabi Island.[63] However, it was not until 1960 that oil was found in commercial quantities at Murban. Meanwhile, another concession was granted in 1953 in Abu Dhabi's coastal waters by Sheikh Shakhbut to Abu Dhabi Marine Areas. The company focused its drilling activities on Das Island, a small, uninhabited island 60 kilometers from Abu Dhabi, and struck oil in 1958. The discovery rapidly transformed the island into a significant oil camp, and in 1962 the first oil shipment left Das Island.

When Sheikh Zayed became the Ruler of Abu Dhabi in 1966, he immediately renegotiated the concession agreements with the oil companies to get better terms. The relationship between the oil companies, foreign interests, and local entrepreneurs improved, eventually "blossoming into a mutually beneficial association which laid the foundation for the thriving economy in Abu Dhabi today."[64] Currently the government of Abu Dhabi, through the ADNOC (Abu Dhabi National Oil Company) Group of Companies, holds the controlling interest in the emirate's oil industry.

Oil production in Abu Dhabi was followed by production in the emirate of Dubai. In 1952, the government of Dubai granted the first concession to Dubai Marine Areas (DUMA), an offshore undertaking owned two-thirds by BP and one-third by CFP. Eleven years later another concession was granted to Dubai Petroleum Company (DPC), a subsidiary of the American Continental Oil Company. The concession covered the mainland and territorial waters, and in August of 1963 Continental Oil purchased a 50-percent interest in the DUMA to become the operator of the concession.[65]

Other concessions in the territories of the UAE were held by John W. Macom and Pure Oil Company (a 9,380-square-mile oil concession in the Sheikhdom of Sharjah), Shell (a 2,199-square-kilometer concession obtained in January 1967 and relinquished in 1971), and Buttes/Clayco (a 40-year 562-square-mile concession in the offshore waters of the sheikhdom obtained in 1970). On March 20, 1964, Union Oil of California also obtained a 1,800-square-mile concession, onshore and offshore, from Ras al-Khaimah, with the first offshore discovery in 1972. Shell's concession—a 40-year onshore concession granted on March 15, 1969—required the company to begin exploration within 18 months and drilling within three years, with expenditures of $3.5 million on exploration and development within eight years and $9.5 million in bonuses paid on signature. In November of the same year, the Umm al-Quwain government signed

an agreement with the American Occidental Petroleum Corporation for a 40-year 775-square-mile offshore oil concession that required the company to pay a total of $10.5 million in bonuses from signature to daily production of 200,000 barrels. Lastly, the Sheikh of Ajman also awarded a 600-square-mile concession to the Occidental Oil Company in January 1970, with payments of $2.4 million to be made over four years. After BP withdrew from DUMA, CFP increased its share to 50 percent, and DPC discovered the Fatah field located 50 miles off the coast. Production began in September 1969.[66]

The oil industry has been the major determinant of transformation and economic growth in the emirates, from Abu Dhabi to Sharjah. Virtually everything in Abu Dhabi has come about because of oil revenues. The decline of the pearling industry in the 1930s created a desperate situation in the emirates, particularly in Abu Dhabi, as the majority of the citizenry faced unemployment and poverty. It was not until oil exploration and drilling began, and even more so when oil was discovered in commercial quantities a decade later, that people of the emirates began to enjoy what must have seemed unimaginable economic and social conditions.

Qatar

Prior to the discovery of oil in Qatar, the country was about the most primitive in the Persian Gulf region—a great barren peninsula, 160 kilometers long and 55–90 kilometers wide, extending from Saudi Arabia into the Persian Gulf, with very little fresh water and little prospect for agricultural cultivation. Prior to the discovery of oil and natural gas and as in the case of a number of other Persian Gulf sheikhdoms, the people of Qatar depended on pearling and fishing for income. Ruled by the Al-Thani family since the 1870s, Qatar was under the Ottoman Empire from 1872 to 1914.

Qatar's oil fields were of interest as early as 1922 to Major Frank Holmes, the New Zealand-born British oil businessman who represented the Eastern and General Syndicate's ventures in the Middle East. A few years earlier, Holmes had helped obtain oil concessions in Saudi Arabia and in other Persian Gulf countries, and although he was interested in obtaining a concession in Qatar, he was unable to do so because of the refusal of the British Colonial Office.[67] However, these objections did not last long. In early 1926, "George Martin Lees, a geologist with the Anglo-Persian Oil Company (APOC), visited Doha and made a one day trip to a few outcrops of Qatar, which he rightly identified as Eocene limestone exposed on the crest of a gently-dipping

anticline; Before leaving, Lees also obtained permission from the ruler to explore the emirate for the following two years."[68]

In September 1932, after it became known that SoCal had been granted the concession in Bahrain, APOC obtained an exclusive license for a two-year geographical examination of Qatar.[69] In response, APOC sent C. C. Mylles to Doha to negotiate an oil concession with the Sheikh.[70] Since this was a violation of the Red Line Agreement signed in 1928, the IPC agreed that the Qatar license should remain in the name of Anglo-Persian as the nominee of IPC. After geological examinations revealed favorable oil prospects in Qatar, APOC was authorized to negotiate a concession with Qatar. In 1932, two geologists, E. W. Shaw and P. T. Cox, were dispatched by APOC, and "after a survey during January-March 1933, the team found out that the Dukhan anticline in the southeastern Qatar shared similarities with the discovery field in Bahrain: Its surface rocks were Eocene limestone and hence good potential for a Cretaceous reservoir rock."[71] On May 17, 1935, a 75-year concession covering the entire territory was granted to the company,[72] and in return "the Qatar government was to receive a royalty of 2 Indian rupees [R] per ton of oil produced, a payment of R400,000 on signature, and annual sums of R150,000 (after five years, R300,000)."[73] Despite the field being comparatively large, the peninsula's potential was not fully explored.

Two years later, in 1937, an IPC subsidiary, Petroleum Development (Qatar) Limited, took over the concession from the AIOC—it provided for a royalty of R2 per ton. This new company "included BP (23.75%), Royal Dutch Shell (23.75%), Compagnie Francaise des Petroles (23.75%), Standard Oil of New Jersey (11.87%), Mobil (11.87%), and Paratex (Gulbenkian Foundation) (5.0%)."[74] From 1937 to 1938, more geologists, including Norval E. Baker, T. F. Williamson, and R. Pomeyrol, visited Dukhan to locate a drilling site, and upon examination they recommended a location for the first well.[75] In late 1938, drilling operations began by Petroleum Development Limited, later known as the Qatar Petroleum Company; while the company was "mainly under British management locally, it included American, French, and Dutch interests."[76] Oil was found a year later in commercial quantities in the Dukhan field, but as in Kuwait operations were closed down for the duration of the war.[77] By 1940, 4,000 barrels per day were being produced. In 1947, operations were resumed and a 51-mile pipeline connecting the oil field with the eastern corner of the peninsula was completed. Oil exports officially began on December 31, 1949.[78] Originally, "the rate of the royalty was fixed at R3 per ton, but in September 1952 the company entered into a 50–50 profit sharing

agreement with the ruler, as a result of which he began receiving an income of about 5 million pounds a year."[79] The agreement increased Qatar's revenues from $1 million in 1950 to $23 million in 1954.[80]

Qatar's oil production was about 33,800 barrels per day by 1950, steadily increasing almost threefold by 1954. Meanwhile, Shell Petroleum Qatar had an offshore concession at two fields, Idd al Sharqi and Maydan Mahzam, with daily production capacities of 35,000 and 100,000 barrels, respectively.[81] The government also granted an exploration permit that covered some 3,000 square miles in onshore and offshore areas. This concession, covering 25,900 square kilometers, was for 75 years and "included an initial payment of £260,000 to the Sheikh, and a fifty-fifty profit sharing after production; field operations were bound to start within nine months and drilling within two years."[82] After seismic surveys beginning in 1953, Shell discovered the Idd al Sharqi oil and gas field in May 1960. Then in 1963, Shell discovered another major offshore field, Maydan Mahzam, from which production started in 1965. By 1969, production was about 35,000 barrels from Idd al-Sharqi and 100,000 barrels from Maydan Mahzam.

As mentioned earlier, at the time of oil discovery, Qatar was more primitive than the other smaller countries in the region, such as Bahrain and Kuwait. Besides depending on pearling and fishing for bare subsistence, the people of Qatar had practically "no education and no direct contact with the world outside the Persian Gulf and Arabia, and almost all the necessities of life were imported by country craft from Bahrain, Dubai, or the Persian Coast."[83] As was the case in the neighboring emirates, the flow of oil revenues moved the country from poverty to prosperity. Oil revenues "fueled the development of economic infrastructures, new welfare systems, and radically different and at least materially better lives for their inhabitants."[84] Still, Qatar remained backward until late 1949, when ruler Sheikh Abdullah abdicated in favor of his eldest son, Sheikh Ali, who immediately "engaged a British Adviser, and a British Political Officer was appointed to Doha; since then steady progress was made."[85] This included an annual budget, with oil revenues being allocated on the basis of "one-third to current expenditure, one-third to capital development, and one-third to a reserve; a law court with proper administering of justice; a police force; services of British doctors and engineers; fresh water piping; a distillation plant; a primary school; and an airport, amongst others."[86] These basic changes were particularly significant to Qatar because the country lacked even proper schools until 1950, leaving the bulk of the population illiterate. Simply said, Qatar had been almost cut off from the modern world, but oil was to change everything.

Summary

In 1900, before oil exploration, production and exports, the countries of the Persian Gulf were poor, with Iran and Iraq somewhat better off than the others. While Iran and Iraq had sizeable agricultural sectors, and Iran had traditional exports (rugs, textiles, and dried fruits), all of the major oil-exporting countries among today's Gulf Cooperation Council (GCC) countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE) were by any measure extremely poor before oil came on line. Saudi Arabia relied on revenues from pilgrims coming to Mecca and Medina, while the others relied on fishing and pearling. Although the benefits of oil were still hardly visible until well after World War II, oil was to transform the face of these countries beyond recognition.

Negotiations between producing countries and Western oil companies were not between equals throughout the period from the discovery of oil early in the twentieth century up to the end of World War II, a time when Iran, Iraq, Kuwait, and Saudi Arabia were exporting their oil. The companies dictated all the terms on a take it or leave it basis, something that was most vivid in British dealings with Iran, the country with the longest history of oil production and export in the region. The foreign companies essentially determined the specifics of oil concession agreements. They controlled oil exploration and production, as well as the sharing of profits in these countries. The companies did not share the most basic business information, such as profit and loss statements, with the countries. The companies colluded with the blessing and support of their governments to reduce the bargaining power of the producing countries. The threat of oil boycotts and military interventions were vivid and real, because the companies operated with the full support of their imperialist governments. By any standards, the oil-exporting countries were shortchanged and exploited. The British approach with Iran was much harsher than that of the American companies with Saudi Arabia. In fact, the participation of American companies may have been a major factor in "softening" the British. The less than fair treatment of Persian Gulf countries by foreign oil interests was bound to fuel popular resentment that would continue in the minds of citizens for generations and fuel future conflicts. European powers, principally Britain, were imperialists, and Persian Gulf countries were for all intent and purposes treated as their colonies.

Still, during most of the period before the formation of OPEC in 1960, the rulers and governments of these countries did what they

could to get a fairer share of the profits from oil production and sales for their countries (and of course for themselves and their supporters). They were, as stated above, negotiating from a position of weakness with looming economic and military threats. All this, as we will see in the next chapter, was changed by market conditions—growing global demand for oil, an increasing OPEC share of world production and exports, the entry of independent oil companies with very limited sources of crude into the international markets, and a strengthening of the financial and economic position of Middle Eastern countries. The oil-exporting countries replaced the cartel of the major international oil companies, or the "Seven Sisters," with their own cartel of the OPEC.

All along, the major oil companies and the Western countries that supported them became accustomed to dealing with absolute rulers. It would appear that they even became fond of pliant dictators! It is easier to make a deal with a strongman, especially if he is corrupt, than with a representative government that has a legitimate parliament, seeks answers to questions, and is answerable to the people. So in support of their companies, the Western governments backed the strongmen in the name of stability, the free flow of oil, moderate oil prices, and of course profits. These dealings poisoned the relations between the citizenry and the foreigners—the companies and, more importantly, the countries—for years to come, in some countries even today. At the same time, the cooperation of Persian Gulf leaders with foreign governments coupled with their corrupt rule and extravagant lifestyles alienated the citizenry from their own leaders.

As we shall see, all this laid the foundation of what has become the Persian Gulf and the greater Middle East of today—a region with unelected leaders who thwart any movement to establish justice and better institutions—and a region that continues to resent the historical and overpowering role of foreigners in its oil industry and its political, social, and economic development. While most former colonies were cut loose after World War II and left somewhat to their own devices to develop in fits and starts, the countries of the Persian Gulf, though not strictly colonies, were reigned in because of their oil. They were prevented from reforming and experimenting with change, which might have been at times violent. Instead, foreigners stepped up their support of oppressive rulers in the name of stability.

Appendix: Oil—Facts and Prices

Oil Facts

Contrary to popular belief, all crude oils are not the same. They don't look or smell the same. While there are well over a hundred types of crude, depending on where they are found (similar to the wine regions of France), there are two important characteristics that are used to classify crudes—specific gravity (that is, the density, referred to as light, medium, or heavy) and sulfur content (referred to as sweet or sour). "Heavy" crudes are those that have an API (American Petroleum Institute) specific gravity of less than 20 (the lower the specific gravity, the higher the density of the crude), "light" crudes are generally those with an API in the range of 32–42, and "medium" crudes are those with an API in the middle range of 20–32.

The characteristics of crudes matter for a number of reasons: (i) the heavier the oil, the harder it is to pump through pipelines and the more expensive it is to refine into the higher-priced fuel products—jet fuel and gasoline; (ii) sweet crudes are less expensive to refine; and (iii) most refineries are built and configured to refine a particular type of crude and produce a given mix of products (refineries can be built to handle a range of crudes and produce a wider range of products, but such refining flexibility increases design and construction costs). It is precisely because all crudes and refineries are not the same that a shortfall in the exports of Libyan crude (which is both light and sweet) during the Libyan crisis (2011) could not be immediately replaced by Saudi exports of a heavier sour crude; and it also takes time to reconfigure refineries and to shift the destination for crude exports and refined products, namely, to where they are in demand.

Also, and crucially, the extraction of crudes that are similar to Libyan crude may not be increased quickly because of limitations on sustainable installed capacity. Oil fields have a capacity and while output may be increased somewhat and temporarily beyond capacity, extraction beyond a certain rate can damage the field and significantly

reduce the amount of oil that can ultimately be recovered by conventional means. Similarly, a rapid reduction in lifting oil can damage a field and reduce recoverable oil; thus if demand goes down, a producer may want to maintain production and put the oil in storage (such as in onshore storage tanks and on floating tankers).

To increase installed capacity for crude production in a region takes time, requiring exploration, reservoir and field development, production installation, and transportation to markets. Depending on the location, this could take up to seven to ten years.

It is for the reasons above that a major oil field disruption (fires, wars, etc.) could have a significant adverse impact on oil prices, especially if excess global installed capacity is low and there is no excess capacity in the type of crude that was disrupted.

The most frequently cited crude benchmarks and prices are: Brent (North Sea), West Texas Intermediate, Arabian Light, and the OPEC Basket (a mix of different crudes). Another factor (besides crude quality) that affects the price of crudes is its location, namely, how difficult it is to transport and how close it is to the market.

From the crude producers' side, the factor that may be the most important about any crude oil is its production (or lifting) cost, and this varies dramatically across the world depending on the size of the reservoir, the condition of the reservoir, the depth of the oil from the surface, and the nature of the general surroundings. While precise figures are trade secrets, here are some rough figures for the marginal cost of a barrel (the cost of producing an additional barrel) and the average cost (including all costs such as development and capital costs divided by the number of barrels produced) that we have compiled over the years: Persian Gulf onshore (marginal $1–3 and average $5–10), North America (average $15–40), Arctic fields (average $35–100), and deep offshore (average $30–70). Modern technology has also increased the availability of crude oil through enhanced oil recovery methods from existing reservoirs and from nonconventional sources (oil shale and tar sands): enhanced recovery (average $30–70) and nonconventional (average $35–120). The advantage of Persian Gulf oil is clear—it is the cheapest oil to produce and to get to market. This affords Middle East oil exporters an unbelievable operating margin (or rent from their oil resources) when oil is selling for about $100 per barrel.

Now let's turn to where we find crude oil. Besides having the cheapest production cost, the Persian Gulf has crude in abundance. The Persian Gulf has over 55 percent of the global reserves of conventional crude oils; a figure that will likely increase to about 60–65 percent as exploration activity in Iraq picks up, economic sanctions on Iran are lifted,

and conventional reserves outside the Persian Gulf are depleted more quickly than those in the Persian Gulf. The country-by-country reserves in billions of barrels as of the end of 2011 were: Saudi Arabia (265), Iran (151), Iraq (143), Kuwait (101), the UAE (98), and Qatar (25).[1] Estimated reserves of recoverable oil from nonconventional sources are roughly on par with conventional crude reserves. While the Persian Gulf is the center of conventional crude oil reserves, North America (the United States and Canada) and Venezuela are at the center of crude that may be recovered from shale and tar sands, with North America having about 50 percent of the global reserves from these sources.

The role of technology in all of this must be appreciated. The reserve figures are rough estimates with the level of technology that we have today. Advances in technology, in exploration, drilling (offshore platforms and horizontal drilling), enhanced recovery, and extraction from nonconventional sources add to reserves and increase the lifespan of oil-based hydrocarbon fuels. Technology, in turn, is in large part driven by oil prices. As oil prices rise, it is more profitable to develop new technologies and to produce from oil fields that were previously unprofitable.

While oil continues to be the most important traded fuel in the world, natural gas has become increasingly significant over the last 30 or so years. There are two major sources of conventional natural gas: associated or wet gas (gas that comes out of the ground along with oil) and unassociated or dry gas (fields that produce only gas and few or no liquid hydrocarbons); and a number of sources of unconventional gas: principally shale gas and, to a much lesser degree, methane from coal beds. The importance of natural gas has increased because it is cleaner fuel than oil (and of course much cleaner than coal where it can be used to produce electricity) and it has in recent years become much more tradable (ships and pipelines). While the Persian Gulf's share of global conventional gas reserves at about 40 percent is well below its share of oil reserves, it is still the largest of any region, with giant reserves in Iran (16 percent) and Qatar (14 percent), and the reserves of these two countries and the Russian Federation together amount to about 55 percent of global conventional reserves of gas.

While shale gas was produced over one hundred years ago, its potential importance has dramatically increased over the last ten or so years because of technology and discoveries all around the world, especially in the United States, Europe, and China, thus near three major end users; with some experts speculating that shale gas may eventually change the global energy outlook, especially if the adverse environmental impact of shale gas production can be minimized. But

a number of environmental experts argue that hydraulic fracturing (or fracking) and the drilling that goes along with it pose grave environmental dangers. Historically, natural gas and crude oil prices have had a reasonably close association, but in recent years the association has been broken, in part because of the availability of shale gas.

The oil and gas consumption picture is even more clear-cut than the reserve-production picture. GDP of countries and oil and gas consumption go hand-in-hand. While some countries rely more heavily on coal, given environmental concerns, oil and gas are increasingly correlated to economic output notwithstanding the fact that some countries use energy more efficiently in producing $1 of GDP. As for oil consumption, the three biggest consumers of global output are: the United States (21 percent), the European Union (16 percent), and China (11 percent); and as for natural gas consumption: the United States (22 percent), the European Union (16 percent), and the Russian Federation (13 percent). As for trade in oil, the United States, Europe, Japan, and China are the biggest importers, and the Middle East (36 percent) and the former Soviet Union (16 percent) are the major exporters. When it comes to trade in natural gas, the United States is in rough balance, Europe is the big importer, and Russia and Qatar are the major exporters. But all these figures are likely to change dramatically as oil from shale and tar sands and gas from shale come into their own.[2]

Oil Prices

What drives oil prices? Is it supply, demand, speculation, the dollar's exchange rate, political disruptions, conflicts, OPEC, or some other factor? One thing is clear—over this long period of roughly 150 years, oil prices adjusted for inflation (in 2010 dollars) have been in the $10–30 range for all but about 35–40 years, made up of three periods that were highlighted by three major peaks in prices, namely, 1860–1861, 1979–1980, and 2007–2008.[3]

Are prices going to stay high and increase for the foreseeable future and have we, or will we, soon reach the maximum level of global oil output (Peak Oil)? What drives oil prices, is it OPEC, the West, consumers, speculation, or exchange rates? Why the peaks?

Let's start by stating the obvious. Oil prices, like all other prices, are driven by *both* supply and demand. On the supply side, an increase in the immediate or short-run supply of oil is limited by the available excess capacity (of a particular type of crude) and by the oil that is stored in strategic reserves, in company reserves, and

on ocean-ferrying tankers. The long-run supply of oil is not fixed. As oil prices rise, a number of related activities are encouraged on the supply side. New technologies are developed. New areas are explored for crude. New fields are developed. Producing wells are brought on line in the new fields. More crude is produced from existing fields using new technologies. That is, installed capacity to produce oil can be increased and more oil can be produced. But can this go on forever—higher oil prices encouraging new technologies and exploration activities to increase global oil output? No. While new fields come on stream, older fields are depleted and stop producing. It would appear that at some point these opposing forces—additional production from new fields and decline in production from existing fields—will be in balance and at some point thereafter global oil output will likely decline. This is the 64-million-dollar question: will readily accessible sources of crude (even with technological advances) be exhausted, resulting in declining oil production and ever-rising prices, and if so, when? In other words, is there such a thing as Peak Oil and when will it occur?

Although we cannot provide a definitive picture of the long-run oil supply outlook, we can provide some comments that might be helpful. As oil prices rise, energy conservation increases, reducing demand for oil. Oil is used more efficiently. Similarly, as oil prices rise, other energy sources will be increasingly substituted for oil—although within limits, especially in the short run, because substitutes for oil in transportation are not readily available. But still the key point is that as the demand for oil increases and oil prices rise, helpful factors both on the energy supply and on the demand side reduce the pressure on oil supplies. We should note that while new sources of conventional crude come on line (as production in older fields declines), production of nonconventional crude (tar sands and shale) increase and alternative energy sources (conventional natural gas, shale gas, solar, wind, etc.) increasingly substitute for oil. We predict that shale gas will become a critical factor in global energy supplies because of sizeable reserves and diverse sources of supply and because it will provide the cheapest way to combat global warming (with environmental concerns about fracking that must be addressed). Shale gas availability may have already impacted natural gas prices to such a degree that the historic relationship between oil and natural gas prices has become much less discernible.

What about oil demand? The demand for oil, as with anything else, depends on its price, the price and availability of substitutes (including mass transportation), climatic conditions, government regulations,

and, possibly most importantly, GDP. The production of a unit of national economic output, or GDP, requires some energy input, with countries invariably using different amounts of energy depending on what they produce and their energy efficiency. It is for this reason that global economic growth is such an important determinant, or driver, of oil prices. Similarly, rising energy prices impact global economic growth and are an adverse shock to economic growth, a shock whose impact has been somewhat reduced over the last 30–40 years as countries have improved their energy efficiency (an issue that we will address later in more depth).

Besides the basic forces of supply and demand, a number of related factors have also been proposed as important determinants of oil prices. Some have stressed the role of monetary policy, and in particular the US Federal Reserve; as the central bank prints more money, the demand for goods rises. Knowing that money is depreciating at a fast rate, consumers and producers become speculators and develop high inflationary expectations. As a result, producers withhold commodities, anticipating higher prices around the corner. Similarly, consumers rush to buy and store commodities in anticipation of price increases. In the case of oil, the ability of producers to withhold supplies and of consumers to hoard is somewhat constrained; for producers there are high storage costs, potential loss of long-term clients, and damage to oil fields in the event of shutdowns, reducing the volume of ultimately recoverable oil. When consumers hoard oil they incur a significant storage cost. Speculation in the futures markets could increase price volatility but, in our opinion, not long-term prices. If a speculator buys an oil futures contract, the purchase adds to the demand for oil. But if the speculator does not take delivery and sells back the futures contract before maturity, then there is no net addition to demand. Some argue that there is an impact from the value of the dollar (the dollar's exchange rate that is in part affected by Federal Reserve policies) on oil prices. The currency is the unit of account; although prices are quoted in dollars, in the end it makes no real difference how oil is priced—in dollars, euros, or yens—although the price of oil may go up or down and by differing amounts in differing currencies because of exchange range movements. Oil is a global commodity, with prices roughly the same the world over after accounting for any differences due to transportation costs and taxes. If oil is priced in dollars and the dollar depreciates relative to the euro, then the price of oil in other currencies falls; this increases the global demand for oil at that dollar price (a shift in the demand curve), with reduced supply at that dollar price (shifting the supply curve), and to restore market equilibrium

the dollar price rises and prices in other currencies go back up toward what they were before the dollar depreciated. Yes, dollar prices move and prices in other currencies do not fall by as much as the dollar depreciation, but it is difficult to establish a direct one-to-one causal relationship between the value of the dollar and oil prices.

Now what about the two recent price peaks (1979–1980 and since 2003)? The first of these price peaks was largely due to the Iranian Revolution and the onset of the Iran-Iraq War, leading to disruption in supply and subsequently some panic hoarding of crude. Iran was a more important exporter of oil at that time than it is today and there was insufficient excess capacity around the world to immediately compensate for any shortfall. But in time, and although the Iran-Iraq War continued with further supply disruption, oil prices (in dollars) declined dramatically during the course of the decade. More Saudi and other sources of crude came online, the dollar appreciated (with the tightening of US monetary policy), and global economic growth slowed down, reducing the demand for oil. The most recent (dollar) price peak was in large part driven by a rapidly growing world economy, especially in emerging markets, and a depreciating dollar.

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Chapter 3

Oil—The Early Years, OPEC, and Its Empowerment (1945–1979)

As we have said in the previous chapter, the zone extending northward under the alluvial plains of the Tigris-Euphrates basin contains around 55–60 percent of the world's known conventional oil reserves. The two richest fields found in the history of man—Ghawar and Burgan—lie along the southwestern shore of the Persian Gulf, in Saudi Arabia and in Kuwait, respectively. Although bitumen and natural gas were exploited in the region millennia ago, commercial oil production in the Persian Gulf started slowly at the turn of the twentieth century (with accelerating exploration and production after World War II), and until the 1960s, foreign oil companies backed by their national governments had total control of the region's oil industry. These companies refined products abroad for their foreign clients, gave the oil-producing countries very little compensation for their crude oil, and earned above-average returns for their foreign shareholders. The oil companies, with the well-deserved nickname of "Seven Sisters" or "Majors,"—Standard Oil of New Jersey (Exxon), Standard Oil of New York (Mobil), SoCal, Gulf Oil, the Texas Company, Royal-Dutch Shell, and British Petroleum—plus CFP, established corporate control over Middle Eastern oil early in the twentieth century. As a result, before World War II, and in fact until the early 1970s, the countries of the Persian Gulf had paltry oil revenues. The countries were in a weak position because geologists discovered oil reserves faster outside the Persian Gulf than the world demand for oil was expanding, with a number of these reserves closer geographically and politically to major consuming centers.

After World War II, a number of oil fields that had more or less been put on hold in the Persian Gulf were developed, and new discoveries

were made, most notably Ghawar in Saudi Arabia. This single field had more reserves than all the oil discovered in the state of Texas, a fact that used to "trouble" my native Texan graduate students no end at the University of Texas at Austin where I was a professor and taught a seminar on oil economics. They could not believe that any country could have more oil than Texas, let alone a single field in Saudi Arabia.

The first high-profile and internationalized confrontation between an oil-producing country and an international oil company came in 1951. The country was Iran and the company was British Petroleum. Mohammad Mossadeq and a group of Iranian parliamentarians, responding to growing internal popular resentment of British control over Iranian oil, decided that it was time for Iran to nationalize its oil industry. This they saw as in the interest of the Iranian people. After Mossadeq was elected as prime minister and the Shah appointed him to the post, parliament nationalized Iran's oil industry by unanimous vote and Mossadeq announced the nationalization on May 1, 1951, creating the National Iranian Oil Company (NIOC).

The British appealed Iran's nationalization decision at the United Nations (UN)-affiliated International Court of Justice (ICJ), established to adjudicate disputes between sovereign nations, an appeal that was dismissed. BP retaliated, with the full support of the British government, by boycotting Iranian oil. BP shut down oil facilities in Iran. The British government threatened legal action against anyone who came to Iran's rescue, who operated its oil installations, transported, or bought Iranian oil. Great Britain had essentially put up an embargo on Iranian oil, although the ICJ had dismissed its claim. Besides this effective blockade of Iranian oil, Britain leaned hard on the United States for support, but the United States was initially not persuaded that intervention in Iran was in its interest. The Shah, fearing for his own life, left Iran. As Iran's financial position deteriorated, Britain managed to persuade the newly elected US President, General Dwight Eisenhower, to help overthrow Mossadeq and restore the Shah to the throne. President Eisenhower appointed the CIA operative Kermit Roosevelt Jr. (a grandson of President Theodore Roosevelt and a distant cousin of President Franklin Roosevelt) to head Operation Ajax to overthrow Mossadeq in collaboration with the British MI6. In 1953, Mossadeq was arrested and the Shah returned to Iran. In the meantime, earlier in 1952, Saudi Arabia, Venezuela, and Iraq had begun to receive additional revenues from foreign oil companies in the form of a 50-percent tax on company profits made in their countries, effectively doubling the countries' profit take on a barrel of exported oil.

It may be instructive to pause and imagine how Iranians must have felt toward the coup that overthrew their legitimately elected prime minister. How did this event shape their attitude toward the United States and Great Britain? And how would the coup play out with future generation of Iranians? Iranians had viewed the United States as a friend after World War II, because it was the United States that had come to Iran's rescue and supported Iranian efforts to pressure a Soviet exit from its occupation of northern Iran. But the coup poisoned what could have been a close working relationship between the two countries for years to come. While Mossadeq had been hailed as a nationalist, the Shah would now increasingly be seen as an American stooge or lackey. While Mossadeq had promised and stood for democratic reforms, the Shah would act more and more like a dictator who had been imposed by the United States. Whatever the Shah did would be linked, whether by fact or fiction, to the United States (an interfering foreign power) and alienate average Iranians.

Upon the Shah's return to power, it was difficult for the AIOC (renamed BP in 1954) to operate as before. In 1954, the British, under US pressure, had little choice but to accept other oil companies to join in a consortium to develop and produce Iran's oil. In recognition of US support to oust Mossadeq, the Iranian Oil Participants Ltd., as the consortium was officially named, included: BP (40 percent), Gulf or later Chevron (8 percent), Shell (14 percent), and CFP or later Total (6 percent), with each of the Aramco partners—SoCal (Chevron), Standard Oil of New Jersey (Exxon and then ExxonMobil), Standard Oil of New York (later Mobil and then ExxonMobil), and Texaco (later Chevron)—getting an 8-percent interest in the consortium company. NIOC was acknowledged as the owner of the oil (a fact that no one could deny but that had little effective meaning), with the consortium as the operating company. In the negotiations that followed in 1954 and 1955, it was agreed that profits would be shared on a 50–50 basis, akin to the agreement reached earlier by the American oil companies with Aramco. It would appear that the US oil companies had been more accommodating to Saudi Arabia and were now extending the same to Iran. The American companies appeared more amenable to addressing Iranian concerns than the British company had ever been! But three elements continued to bother generations of Iranians. The Consortium's books would not be open to NIOC, an element that made much of the agreement meaningless. NIOC would have no representation on the Consortium's board of directors. And the Consortium would determine all operational decisions without input from Iran. To many educated Iranians, and even the masses,

many of the gains were merely on paper and superficial. Resentment toward foreign influence could only continue to grow.

Mossadeq's overthrow was an important episode in history, especially for the future of the Middle East oil industry and US-Middle East relations, and deserves more discussion and emphasis, but first a digression that is personal in nature. During the period between 1951 and 1953, I had just started first grade in Tehran. Our house was a stone's throw from the Majlis (Iranian Parliament), where much of the action took place, inside and outside the parliament buildings. I remember vividly seeing political graffiti on walls and buildings and bloodstained streets, protests, and scuffles, and above all the mood and reaction of my father, a civil engineer who owned one of the largest civil engineering firms in Iran. During those two years, he looked hopeful and energized. For the first time in my childhood, he discussed political developments with my two older sisters and me. He wanted us to know what was going on in our country and to be proud of our heritage. As government finances began to deteriorate with the onset of the British boycott and the blockade of Iranian oil, Mossadeq turned to selling bonds in the local market. With the full knowledge that the bonds would be worthless, my father was happy to take all that he had and buy the bonds. He even gave each of us thousands of Iranian tomans (ten rials to each toman) to buy the bonds too. It was important to him that we participate in the momentous change going on in Iran. Looking back, I will always wonder how Iranian, Middle Eastern, and global history would have been different if the United States and the United Kingdom had not interfered on behalf of their oil companies. Would Iran, and other countries in the region, have inched forward, albeit with turmoil and setbacks, toward establishing democratic institutions and the rule of law, instead of bottling up much worse turmoil for the future? I have my suspicions, but this is fodder for idle musings on a summer's day in a hammock under the shade of a weeping willow tree!

All of this left an indelible mark on a young boy's life. After my father's death, I left Iran at the age of nine to attend British boarding schools. But unbeknownst to me, Iranian intrigue followed me to England. The uncles of my childhood friend from Iran had a permanent suite at the Grosvenor House Hotel in London. I would go to London and stay with my friend on holidays and on weekends. It was great for two little boys to order room service, play, and have the run of one of the most elegant hotels in London of the mid-1950s. There were always lots of comings and goings—an impressive English woman (I think Ann Lambton) and some Englishmen

(including, I think the British Consul in Mashhad). I later discovered that my friend's uncles were the British Iranian agents in Iran and the visitors were the who's who of the British Foreign Office. But I have never forgotten what happened in those two years in Tehran. I have thought about it on many occasions. I keep asking myself, what if Mossadeq had remained in power? Would Iran be the same? Would the mullahs have taken over as they did in 1979? Would the Middle East be the same? These events again touched me in 1981 in a way that I could never have imagined earlier in my life. At this time, in early 1981, I was the Special Advisor to the Minister of Finance of Saudi Arabia, Sheikh Mohammad Abal-Khail, a man of great intelligence, shrewdness, and decency, and a man from whom I learned a great deal.[1] I was on one of my visits to Riyadh to see the Minister. During the visit, the Minister asked me to come to a small luncheon in honor of David Rockefeller at the Jockey Club in Riyadh. I did as requested. When I arrived, the Minister was already there with the head of the Saudi Arabian Monetary Agency or SAMA, Sheikh Abdulaziz Al-Qureishi, another admirable man, who encouraged my smoking of Dunhill cigarettes because his family held the franchise for Saudi Arabia! As we stood by the table set for five, the minister told me that we were waiting for Mr. Rockefeller and one of his advisors, a Mr. Kermit Roosevelt (the Minister omitted the Jr., but I knew who he meant). My jaw dropped. It must have been so obvious that the Minister asked me what was wrong? I told him about Kermit Roosevelt's spearheading of the coup against Mossadeq and the role that incident had played in my childhood and then asked him if I could be excused, as I did not want to be in the same room, much less have lunch, with Kermit Roosevelt. He said, "Hossein you must grow up. You will sit next to Mr. Roosevelt, on his right." I had no choice. It was the longest meal of my life.

I have recounted these personal episodes for one reason, and one reason only. The exploitive and heavy-handed role of the oil companies, the involvement of imperialist powers, the collaboration of Iranians, and especially the overthrow of Mossadeq left an indelible mark on a privileged child's mind and on many Iranians of my generation. It was, and still is, tough to separate oil from imperialism and international political economy. And along the way, the human, political, and economic development of Iran was undoubtedly compromised for generations, if not centuries. The "what-if" will continue to haunt me to my grave.

Iran's dealings with the oil majors and the great Western powers up to the overthrow of Mossadeq afford a number of lessons for

assessing the evolution of the political economy of oil in the Middle East. During the 1950s and of course for decades before, the major oil companies, supported by their powerful governments, were in total control of the global oil industry. The companies and the foreign governments were heavy handed. The threat of force was always on the table. They thwarted attempts by producing countries to capture a larger share of the profits from the exploitation of their oil. This they could do because they had oil reserves and production elsewhere, they could live without Iranian oil because the oil market was awash with oil. In other words, the companies had available capacity elsewhere in the region and around the world. In addition, it was the companies who had all the customers. They could band together and boycott a problem country's oil exports. For all these reasons, they were in the driver's seat when they bargained with the producing countries. Moreover, the governments of the countries the majors called home sanctioned collusion among them. For example, in the case of the United States, oil companies were explicitly exempted from the provisions of the Sherman Act in their dealings with foreign governments. The Sherman Act was designed to foster competition and prevent the organization of cartels and monopolies that are harmful to business development and to the welfare of consumers. The Sherman Act has been at the foundation of good corporate behavior and the bedrock of antitrust litigation in the United States for well over a century. Yet the US government saw it fit to encourage collusion and cartels when it came to their oil companies and their dealings with individual foreign governments—enriching oil companies and their shareholders at the expense of poor countries and their citizens. While the colluding companies supported by their governments held the winning hand, the oil-rich countries held few cards: they were weak, they were poor and desperately needed their meager revenues from oil to survive, they had little control over their oil production, they had no customers, and they were not united. Market power and political power favored the international oil companies.

A second lesson was that the home governments of the majors used covert operations and military force in support of their oil interests. Oil and international politics and intrigue were truly inseparable.

Third, the strong unified front presented by the oil companies and their governments was also a lesson for other would-be upstart countries in the region. While other countries, most notably Iraq, attempted to wrestle away control of their oil industry, their efforts were futile in the face of a glut on the world oil market, collusion among the majors, and disarray among the producing countries.

Imperialism ruled when it came to oil exploitation in the Middle East! But at the same time, unity would not be something the producing countries could easily achieve because ethnic and sectarian divides, centuries of mistrust, and the quest for rulers to stay in power would likely trump all else.

Fourth, even if the oil-producing countries could have united, their unity would have meant little if the world could have done without their total, or aggregate, oil output. Market power (controlling production and the buyers) always matters more than talk.

When it came to oil production and country revenues, the story was much the same in neighboring Iraq. In 1958, revolutionaries overthrew the monarch in Iraq. As with the monarchy, the revolutionary government of Abdul Karim Qassim appeared to have relatively cordial relations with IPC. But this was not to last. Iraq needed more revenues and revenues took a big dive in 1959 and 1960. But with Mossadeq and Iran on their minds, the Iraqi leaders dared not take unilateral action against the operating oil company.

Oil prices had languished in the 1950s and were unilaterally cut by the oil companies in 1959 and 1960, resulting in declining oil revenues. Iraq (also upset that IPC was operating on less than 0.5 percent of its concession land area) convened a meeting of Iran, Kuwait, Saudi Arabia, and Venezuela in September of 1960 that would establish OPEC (with membership over time expanded to include Algeria, Angola, Ecuador, Libya, Nigeria, Qatar, and the UAE, and Indonesia withdrawing as a member after becoming a net oil importer). Ironically, OPEC's original goal was to arrest declining prices and revenues, as opposed to increasing oil prices. For this reason and the fact that there was a global oil glut, the formation of OPEC in 1960 did not cause any waves around the world. It was a nonevent. There was little fear of what OPEC might do. And in fact OPEC (with the early addition of Indonesia and Qatar) could not even unite to support Iraq in its dealings with the oil majors in the early 1960s. As we will see all that would change in a little over a decade.

The Iraqi revolutionaries were the first to test the commitment of OPEC members to the organization and its goals. In 1960, Qassim demanded 20-percent ownership and 55 percent of IPC's profits for Iraq. IPC rejected these demands. As a result, in December 1961, Iraq adopted Law Number 80. The law expropriated all concession areas not operated by IPC and proposed establishing the Iraq National Oil Company (INOC) to oversee oil production in the area expropriated from IPC. The foreign companies were worried about losing the potentially valuable Rumaylah field in southern Iraq and

more importantly the message that would be sent to the other oil-exporting countries. Iraq had hoped that OPEC members would join Iraq and adopt a unified position in their negotiations with the oil companies. Instead, each country negotiated separately, with the oil companies extracting concessions and reducing Iraqi output to teach the Baghdad revolutionaries a costly lesson. The other OPEC members were happy to see their output increase at the expense of their Iraqi brothers. OPEC's power was almost nonexistent in the early 1960s. Market conditions were not favorable for the oil producers, and the producers were weak and did not have sufficient incentive to unite and confront the oil companies.

In 1964, Iraq established INOC, but IPC continued to be the major producer and exporter of oil in Iraq, largely from the Kirkuk field. In 1967, Iraq negotiated an oil service contract with the French government-owned firm, Entreprise des Recherches et des Activites Petrolières, and turned to the Soviets for help in developing the vast Rumaylah field; all the while the confrontation with IPC continued into the early 1970s. Eventually in June 1972, Iraq nationalized IPC's remaining holdings in Iraq, principally the fields in Kirkuk. Claims against nationalization and counterclaims followed. These were settled in 1973, with Iraq having total control over its oil resources.

While collusion and political and military backing were essential to the dominance of the majors, the importance of prevailing market conditions cannot be overemphasized. Vast reserves of oil were being discovered in the Middle East and brought on line after World War II, activities that had been more or less put on hold during the war. During the war, global oil prices had surged. But after the war, as more Middle Eastern oil came on line, prices adjusted for inflation started a steady decline, beginning in 1947 and through the early 1950s, they held steady during most of the 1950s, declined slowly but steadily during the entire 1960s, and during that decade they lost about a third of their real value. The world was awash with oil. In 1959, the United States adopted mandatory oil import quotas, restricting oil imports to a maximum of 12.2 percent of US production. I remember going to Iran in 1968 at the behest of an American business group planning a refinery in Machiasport, Maine. They wanted to import Iranian oil for a refinery in Maine, but they needed an import license from Washington. The Iranian government, a big ally of the United States, and the politically wired group in Maine lobbied Washington, but to no avail. Oil prices were low and for internal political reasons in the United States, domestic producers had to be protected from external competition. Faced with a glut on world markets beginning

in the early 1950s, the majors had cut prices for Middle Eastern oil, in turn reducing Middle Eastern oil revenues. Oil was not only inseparable from international politics but was absolutely woven into the domestic political fabric of the United States.

A number of simultaneous developments brought OPEC to the fore and to world attention. First, global oil consumption exploded after World War II, from 370 million metric tons in 1946 to 1,079 million tons in 1960 and an unbelievable 2,336 metric tons in 1970; or, put into barrels per day, from 11 million in 1950 to 53 million in 1970 or a 400-percent increase in oil consumption in a mere 20 years.[2] Second, OPEC's position in the market became increasingly significant, with OPEC's share of world oil production increasing from 24 percent in 1946 to 40 percent in 1960 and 50 percent in 1970. Third, and even more important than production share, OPEC's share of world oil exports rose from about 40 percent in 1946 to 70 percent by 1970. The share of oil exports is in a sense the key indicator, because by 1970 nearly every additional barrel of oil exports came from OPEC sources and the producer of the marginal barrel of exports, or OPEC, was gaining price-setting powers. Fourth, and in our opinion as important as all of these market developments combined, was the fact that the oil majors (the Seven Sisters plus CFP) were increasingly losing their ability to act as an effective cartel (as a unified group of buyers or monopsonists) in their dealings with the OPEC countries.

Libya, in the person of Colonel Qaddafi, by luck or by design, played a key role in breaking up the power of the major oil companies. When oil companies came into Libya (with oil starting to flow in 1961), they were given smaller blocks of land for exploration than they had received from the countries of the Persian Gulf, where they initially got concessions for all of a country in some cases. Moreover, the "independents" (oil companies such as Continental Oil, Occidental Petroleum, Amerada-Hess, and Marathon Oil), as opposed to the majors, became very active in Libya along with the majors in the 1960s, with the independents lifting about 60 percent of all Libyan oil. The independents, besides being much smaller and financially weaker than the majors, did not have the diverse sources of crude oil that the majors enjoyed. For these two reasons Libya could play the independents and the majors against each other and could exploit the vulnerability of independents that relied heavily on Libyan oil—the dependence of every major oil company on Libyan oil was less than 5 percent, while each of these independents relied on Libyan oil for over 40 percent of their worldwide sources of crude, with Occidental depending on Libya for over 96 percent of its worldwide supply of crude.

In 1965, Libya demanded higher royalties and taxes, which it got, and then in 1967 it demanded a premium for its crude because of its location west of the Suez Canal (nearer the markets and thus cheaper to transport than crudes that came from farther afield, given the fact that the Suez Canal was closed after the Six Day War in 1967 until June 1975), and again it won. The reason was simple. Although the majors offered their own crude oil at the Libyan price to the independents if they would not cave in to Libyan demands, the independents, in particular Occidental Petroleum, did not see this as a viable long-term option. If they accepted the offer of crude from the majors they would be at their mercy and could not grow as companies. They would rather throw in their lot with Libya. Capitulating to Libya would at least keep the independents on par (and possibly even better off since they were not alienating the mercurial Colonel Qaddafi) with the majors for access to Libyan crude. As expected, the independents caved in to Libya. The majors were worried not so much about their position in Libya since Libyan crude accounted for a small fraction of their worldwide crude supplies, but about how caving in to Libya would play out elsewhere, especially in the Persian Gulf. With producer country demands rising and spreading throughout the Middle East, Libyan price increases could be contagious in the Persian Gulf. This is in fact precisely what happened, and the oil companies' worst nightmare soon became reality.

The closing of the Suez Canal in 1967 following the Arab-Israeli War, a shutdown that was to last for about eight years, also helped Libya in its negotiations with the oil companies. The proximity of Libyan oil to the European markets gave it an important advantage over Persian Gulf crudes, because the closing of the Suez Canal increased the transportation cost of Persian Gulf oil. Colonel Qaddafi put further pressure on the oil companies because of the higher quality of Libyan crude (sweet and light), which made it cheaper to refine, and its much lower cost of transportation to the large European market.

These victories for Libya, albeit small, motivated the major producing countries of the Persian Gulf to at last unite almost ten years after the founding of OPEC and to escalate their demands. While OPEC had achieved little in its first ten years, all that was about to change in the following ten years. The Persian Gulf oil exporters stuck together in supporting Libyan demands because they had nothing to lose. After a series of Libyan successes, OPEC became motivated to collaborate to secure the Tehran Agreement. The Shah of Iran was "insulted" at Qaddafi's success and wanted the same for Persian

Gulf producers. The Shah literally could not accept the fact that the "madman of Africa" (the Shah's nickname for Qaddafi) was getting a higher price for his oil than the Shah was getting for Iranian oil. The Persian Gulf producers and the rest of OPEC got all they wanted and more in the Tehran Agreement of February 1971, including their biggest price increases ever. But price escalations did not end here. Libya again demanded a premium over Persian Gulf oil after the Tehran Agreement, and got a premium of $0.80. All this set the stage for the quadrupling of oil prices from roughly $3 per barrel to $12 per barrel during 1973–1974.

While this big jump has been popularly attributed to the October War of 1973 and the Arab oil boycott, its foundation, in our opinion, was laid down much earlier by changing market fundamentals—the rapid increase in global oil consumption and OPEC's increasing share of oil reserves, production, and exports—along with the participation of the independent oil companies in Libya, the closing of the Suez Canal, the Shah of Iran's hawkish insistence on getting a higher price for Iran's oil after Qaddafi's success, and the newfound cooperation among the members of OPEC from 1970 to 1973. OPEC had come to the fore, because market conditions had improved in its favor and its members had nothing to lose and everything to gain. The October War was merely the catalyst. In our opinion, these few years, from the late 1960s to1974, were OPEC's most successful years as a cartel.[3]

While OPEC's founding was motivated by the desire to arrest declining revenues for member countries in dealing with the major oil companies, which had acted as an extremely successful cartel for decades with the blessing of their home governments, OPEC's later ambitions became more focused on raising and controlling oil prices. Let's briefly examine what a cartel does and the attributes of a strong cartel. The members of a cartel collude on the level of output (assigning output levels to each member), with the goal of manipulating prices—level and volatility. In other words, in contrast to independent producers who make their own production decisions without coordinating output to fix the market-clearing price, cartel members collude on their output levels to fix prices and earn monopoly profits over time at the expense of consumers.

What makes a strong cartel? Unity is key. Unity is needed to demonstrate to members and perspective members that they can gain by joining, colluding, and sticking together in dealing with buyers of their product. Unity also sends an important signal to the other side (in this case the oil companies) that you will not blink. OPEC failed in both these regards throughout the 1960s, but managed to unite

to extract the Tehran Agreement from the oil companies in 1971. OPEC members appear to be able to unite if and only if they have nothing to lose, both economically and politically. In contrast, the oil companies were united throughout the 1940s, 1950s, and 1960s, and it was not until the early 1970s that Libya managed to drive a wedge between the independent oil companies and the major oil companies. The danger for OPEC, as for any cartel, has been that members will agree to production quotas but then cheat; or not agree to production quotas at all; or afford nonmember oil producers the benefits of their collusion without the cost of having to restrict their output level (getting a free ride on the back of OPEC, that is, higher prices and no obligation to limit output levels, as with countries such as Russia and Mexico). But during the Arab Oil Embargo of 1973–1974, the longer-term cracks of OPEC unity should have been foreseeable. Arabs, especially Saudi Arabians, and Iranians will always find reasons to undermine one another. The same goes for Sunni and Shia Muslims. The wide disparity in oil wealth from country to country could be another source of division, aggression, and conflict. Strongman rule, as compared to representative government, is more prone to conflicts and wars; one man's decision is more likely to be impetuous than the collective decision of an elected group. The reliance of oppressive rulers on foreign support becomes a source of division among cartel members; rulers were likely to do anything to stay on the job. Moreover, for all GCC rulers, survival, which means US political support, is what matters most, distantly followed by the financial benefits of OPEC unity.

A second key attribute for an effective cartel is product characteristic. It helps if the product is an essential product, which oil is; and has no ready substitute, which again is the case for oil when it comes to its use in transportation. Along the same lines, it helps if the product has a low price elasticity of demand; that is, as prices go up, demand goes down at a lower rate. It is also helpful to a cartel if the product is hard to store and has a high storage cost (buyers cannot store for emergency use and thus have less negotiating power). A third important attribute is high market share (in production and especially in global exports). The higher the market share of cartel members, the higher their market power to set prices. OPEC market shares, while falling for a number of years beginning in the mid-1980s, have recovered and will continue to grow until more unconventional crudes and shale gas come online and renewables become more price competitive. A fourth helpful attribute for a cartel of sellers is numerous buyers and their disunity. Again, oil fits the bill and supports the OPEC position.

A fifth key attribute for an effective cartel is that members have the financial means to forego sales longer than buyers can do without the product. That is, members of a cartel do not want to blink first. The financial strength of members and/or their ability and willingness to support each other financially through periods of revenue shortfalls is an important factor for unity and cohesion, and in turn for the ability to negotiate with the buyers of their product. In the 1950s, none of the countries that later became OPEC members were in a sound financial position. In the 1960s, only Kuwait was relatively strong financially, with a significant level of financial reserves to finance import needs for a number of months. Saudi Arabia was literally bankrupt. Although all the brothers had promised their father, King Abdulaziz, that they would follow each other on the throne by age, they (reportedly unanimously) felt that their survival was threatened by King Saud's profligacy and mismanagement. The brothers had Faisal replace his half-brother in order to restore financial stability. The other countries, though not bankrupt, were not in great financial shape either. After the Tehran Agreement in 1971, financial conditions improved rapidly for all members, even though some members, such as Iran, went on wild shopping sprees, buying everything imaginable including expensive military hardware that had little or no productive economic value. But at no time have OPEC members helped one another financially in the face of tough negotiations or standoffs with buyers of their oil.[4]

Although the OPEC success of the early 1970s was important, it should be remembered that OPEC had done almost nothing in the 1960s to support Iraq, one of its founding members, in its confrontation with IPC's strong-arm tactics. The original OPEC members, joined by Indonesia, Libya, and Qatar, were content to see IPC retaliate against Iraqi demands by limiting its output, while their own output climbed, hardly the behavior of a successful cartel! Again, OPEC disunity was evident during the October War. After Egypt's quick successes, the United States, fearing an Israeli defeat, rushed critical supplies to Israel. The Arabs, led by King Faisal of Saudi Arabia under the umbrella of OAPEC (Organization of Arab Oil exporting Countries), imposed a boycott of oil to the United States and the Netherlands, but with little effect. Oil from other OPEC members, principally Iran, was redirected to the boycotted countries and Arab oil to non-boycotted countries; so much for OPEC political solidarity. OAPEC quickly realized that oil was somewhat "fungible" and that production cutbacks were needed to enforce its goal of impacting the United States (along with other countries). OAPEC agreed

to sequential periodic cutbacks until the United States succumbed. Even in this principled endeavor, OAPEC members did not keep their agreement. Revolutionary Iraq, second only to Saudi Arabia in pressing for the boycott, did not adhere to its agreed share of cutbacks, remembering its confrontation with IPC and the newly created OPEC's cooperation with the foreign oil companies a little over a decade earlier. Also, and as mentioned earlier, even Saudi Arabia secretly loaded oil for the US fleet in support of the Vietnam War effort during the mandated OAPEC cutbacks. All in all, Iran did not support the Arab boycott and both Saudi Arabia and Iraq cheated on OAPEC. It seemed that OPEC and OAPEC members were more interested in short-term financial gains and/or in currying favor with Western powers, especially the United States.

Returning to developments after the 1973–1974 oil price increases, the producing countries nationalized the foreign oil interest around the Persian Gulf. For the first time in decades, the producing countries took total control of their oil industries. Iraq nationalized all remaining foreign interests in 1975. Saudi Arabia started its takeover of Aramco in 1973, taking a 25-percent interest, with compensation to the companies, and completed the takeover by 1980. But their takeover could be classified as friendly when compared to Iraq's and Iran's, with the Saudis giving the four Aramco partners priority access to their oil with special discounts. Thus the Saudi-American oil company relationship has been strong on the whole. Equally important has been the Saudi and US governments' endeavors to maintain their agreement of military and political support for preferential access to Saudi oil. The US-Saudi agreement was different from the deals made by the other Persian Gulf oil exporters. Iran renationalized all remaining foreign interests in the aftermath of its 1979 revolution, with a number of ensuing compensation disputes referred to the Iran-US Tribunal at The Hague. Other oil producers nationalized foreign interests more in line with the "friendly" Saudi approach.

In the aftermath of the big oil price increase of 1973–1974, there were a number of important developments in the region, in the global economy, and in the oil market. The oil-exporting countries spent their newly won oil revenues as if there were no tomorrow. For example, Iran bought all manner of military hardware and gave out costly consumer subsidies. Saudi Arabia kept up with Iran's military buildup and spent even more than the Shah on costly consumer subsidies. The world encouraged them to spend, spend, and spend so as to reduce the increased cost of imported oil. Global inflation picked up, reducing the real price of oil. The international banks did

their part, too. Although the oil exporters did spend, they could still not eliminate their huge current account (net global transactions) surpluses. The banks took in their money and lent it out to Third-World countries (such as Mexico and Argentina) that later defaulted, resulting in the global debt crises of the 1980s. At the same time, higher oil prices encouraged conservation in oil use, stimulated oil production outside of OPEC (North Sea, Alaska, deep sea sources, and the like), and encouraged alternatives to oil, all reducing the demand for oil. The oil price shock dampened economic growth and pushed a number of countries into a recession, again reducing the global demand for oil. Thus, although oil revenues had jumped during 1973–1974, the same oil price hikes set in motion a decline in real oil prices and real oil revenues, with some major oil exporters, especially Iran, facing a financial squeeze.

The oil exporters behaved as if the sky was the limit, namely, as if oil prices and revenues would keep on increasing. They financed lavish subsidies, grandiose projects of little productive value, and wasteful military expenditures. They did not consider their oil as a finite stock of capital that would have to be replaced by alternative forms of capital. In other words, oil should not be exploited to finance consumption but investment. Besides financing consumption, the oil exporters used their depletable oil to finance inefficient consumption subsidies that would be politically difficult to cut in the future as revenues fluctuated. Rulers realized that oil provided a painless means to buy domestic support. But real revenues declined during the late 1970s, and budget and current account deficits began to raise their ugly heads. Iran was perhaps the first to experience domestic dissatisfaction with a slowing domestic economy followed by a recession.

The oil price and revenue increases had important political fallouts for the region. Although the United States had thrown its support behind the Al-Sauds after President Roosevelt's meeting with King Abdulaziz Al-Saud, the United States had increasingly warmed up to the Shah after his return in 1953. By the late 1960s and early 1970s, the United States saw the Shah as a useful surrogate in the region. After Iran's oil revenues jumped and Iran's purchases of US military equipment skyrocketed, the United States in fact adopted the Shah as the "policeman of the Persian Gulf." The United States was preoccupied with the Cold War and Iran served as the US enforcer in the region. Henry Kissinger even persuaded the Shah to send troops to put down the uprising in Oman and to lend senior military advisors to the King of Morocco. The Saudis resented the growing collaboration and cultural affinity between the United States and Iran.

Then came the Iranian Revolution and the onset of the Iran-Iraq War. As oil prices soared to their highest level in real terms ever, the financial position of all OPEC countries, except that of the two combatants, followed suit. But as we shall see in the next chapter, the sun did not shine for long. The next 20 or so years would turn out to be as turbulent as any for OPEC, for Middle East oil exporters, and for citizens of the Persian Gulf region.

How did the post-World War II period compare to the early years up to World War II? On the surface, the period from World War II to 1979 may look like the earlier years from 1900 to World War II. But they were very different, as were the political and economic developments and the lessons they afford. Yes, for most of the period between1900 and 1979, foreigners exploited the wealth of the countries in the Persian Gulf for their own gain and at the expense of the indigenous population. In the early days, companies from Great Britain, and later those in the United States and France, took advantage using the threat of economic boycott, isolation, and military intervention—"conventional colonialism." The oil companies, backed by their own powerful governments, colluded to extract monopoly profits from what were poor countries. They threatened and carried out oil industry shutdowns to get their way, even engineering the ouster of governments. The disputes with the countries centered around: ownership, volume of output, dividend rate, royalty rate on oil lifted, tax on profits, and access to company books to assess profits and other operational numbers (information that is always available to stockholders). The companies were reluctant to give in to one country because the others would demand the same. The companies colluded and stuck together, while the producing countries were weak and in disarray. Under these conditions, popular resentment against the oil companies and their governments grew in the region. Most of the resentment up to the early 1950s was directed at the British because the United States was a latecomer to the Persian Gulf oil scene and treated Saudi Arabia a little better than Britain had treated Iran and Iraq. In fact, Iranians became further incensed at the British on the news that Saudi Arabia, to Iranians an unsophisticated newcomer, had reached a 50–50 profit-sharing plan with American oil companies. The British government had refused to consider a similar arrangement with Iran and simply dismissed Iranian representations and pleadings out of hand.

But in the post-World War II period, conditions began to change, albeit gradually. Market power shifted in favor of the producing countries. They formed OPEC to present a united front against the oil companies. Although unsuccessful for about a decade, OPEC did

produce results in the later 1960s and early 1970s, possibly the four or five most successful years in OPEC's entire history. Producing countries' revenues increased dramatically over the period 1969 to 1974.

Summary

In the first 50 years of oil exploration and oil output in the Persian Gulf, country-company relations were totally one-sided, favoring the companies. The companies dictated the terms on a take-it-or-leave-it basis, something that was most vivid in British dealings with Iran. The companies controlled oil exploration, production, and the sharing of profits in these countries. The threat of oil boycotts and military intervention were real because the companies operated with the full support of their imperialist governments. By any reasonable standards, the oil-exporting countries were exploited.

In the post-World War II period, market conditions began to change, affording Persian Gulf producers increasing bargaining power (higher share of world production and exports). The US-Saudi Agreement undermined the British position in the region. The position of the oil-producing countries was further strengthened by the entry of independents. The formation of OPEC was not the key to their increased negotiating power; instead it was changed market conditions. Yes, the countries clawed away at the companies as they had before World War II, but it was under very different oil market and political circumstances. After World War II, relations were in some sense more painful than before. The countries dared, or were forced, to confront the companies because of domestic resentment, but in return they got more retribution than before. Iran and later Iraq were to pay a heavy price in the short run. The British approach with Iran and later with the revolutionary government in Iraq, was much harsher than that of the American companies with Saudi Arabia.

We believe the fallouts and the lessons of the pre- and the post-World War II periods up to the Iranian Revolution are evident. Simply said, oil and oil revenues have essentially shaped most of the important political, social, and economic decisions in the region. Without oil these countries would have looked very different. This is the overarching message, a message that will become more and more obvious in the chapters that follow.

Rulers of Persian Gulf countries, all unelected, were generally perceived by their people as doing more or less what they could to extract better terms for their people in both periods. But during most of the period before the formation of OPEC in 1960 and into the late

1960s, the rulers and governments of these countries were negotiating from a position of weakness, with looming economic and military threats. For all the period from the discovery of oil into the 1970s, the citizenry's resentment was largely directed at the companies and at their home governments, principally Great Britain, followed by the United States. Foreigners were acting as colonialists as they exploited the oil resources of these countries. Foreigners were the major determinant of the political economy of oil in the region. In those earlier years, all the way from the discovery of oil up to the price hikes of 1973–1974, the major oil companies were the face of foreign power and intrigue in the region. The people did not perceive their rulers as the "villains" throughout the period up to the mid-1970s, but increasingly since that time, the resentment has become redirected toward their own oppressive rulers along with the foreign governments that back them, a resentment that will only increase with time. More and more, as we hope to show in the second half of this book, the rulers of most Persian Gulf countries are cooperating with foreign powers to enrich themselves and their foreign backers, a policy that we will call "collaborative colonialism."

In the aftermath of the price increase of 1973–1974, popular expectations in the Persian Gulf also exploded. The people had waited for decades and they wanted tangible benefits. Unfortunately, governments took the easy route—inefficient, wasteful, and unsustainable consumer subsidies. This was the easy way to buy popular short-run support, but with ominous implications to come, especially for the countries that were less endowed with oil on a per capita basis. And subsidies once given would be very hard to eliminate.

Flush with cash, Iran, Iraq, and Saudi Arabia bought arms. In the case of Saudi Arabia, they also supported US efforts in other ways. They gave special price discounts to the United States as a sign of gratitude for the Camp David Accords. But the Saudi case was different. Oil and political support for Al-Saud rule were intricately linked from the start. No matter what they profess, the Al-Sauds have relied on US support to survive. At the same time the Shah, the US-appointed policeman of the Persian Gulf, had been toppled and a United States that was preoccupied with the Cold War had to adopt a new surrogate in the region—Saddam Hussein.

The oil companies came to see dealings with unelected strongmen rulers they could manipulate as preferable to dealings with elected governments, representative parliaments, and citizen participation. Similarly, rulers in the Middle East could not help but notice that they could count on the support of powerful foreign governments

to hold onto power as long as they supported the commercial and financial interests of the said countries and did their bidding. It was a two-way street between oil companies and rulers. They could collude and protect their respective interests. A representative parliament might demand transparency and accountability and might not deliver on what had been agreed to behind closed doors. A revolutionary government had to deliver on exaggerated promises to wrest control from foreigners and would be less likely to compromise.

The foreign governments, principally Britain, the United States, and France, supported the interests of their oil companies in the region, using intrigue and even military might. Over time, the United States replaced Britain as the principal foreign power in the Persian Gulf region and as the country with the greatest interest in Persian Gulf oil. But foreign force took a different form. Before the mid-1970s, foreigners merely threatened force against producing countries, but since roughly that time they began to use force to support their favored dictators and maintain the status quo.

Economic success or failure is likely to be, in the long run, the main factor shaping the political economy of oil in the Persian Gulf and in the greater Middle East. Will the benefits of oil improve lives more or less equitably and in line with expectations, or will oil enrich a few and leave the rest with only dreams of what might have been? Oil revenues will, at some point in the future, decline. How will these nations then face the future? Some numbers for Saudi Arabia may clarify our point. Saudi oil revenues and expenditures changed dramatically in the course of two decades: 1960 (revenues of $0.45 billion and expenditures of $0.48 billion), 1974 ($27 billion, $9 billion), 1978 ($35 billion, $39 billion), and 1980 ($93 billion, $63 billion), but with deficits every year during the period between 1983 and 1999. The message is clear. If the financial conditions of these countries oscillate in this manner, if other forms of capital do not replace oil optimally, and if the economic benefits are not significant and equitably divided as oil is depleted, domestic and regional turmoil will only grow. Oil depletion must be more just and result in equitable benefits for all generations. Lest politicians in Europe and the United States forget, resentment will fester and live on for years only to raise its head at some yet unknown point in the future and with unknown consequences that could be catastrophic for the region and the world.

Yet sustained economic prosperity must be accompanied by fundamental political reform. In the absence of political reform, economic success will be temporary because the new rulers will adopt the selfish practices and bad habits of the overthrown rulers. Fundamental

political and economic reforms will be very difficult to adopt and maintain in these countries because of the prevalence of sectarian and ethnic conflicts, turmoil, and instability. This is the normal course of events in most transitions of this kind. But because of the vast oil reserves of the countries in the Persian Gulf, the Western powers have not allowed them to struggle with their transition, and instead have supported oppressive rulers to bottle up dissent in the name of stability.

Chapter 4

Oil—The Turbulent Years (1979–2001)

The Iranian Revolution of 1979 was a momentous event for the region, for the world, and for oil markets. After months of popular demonstrations against his regime, the Shah left Iran, in large part to avoid massive fatalities. He did not want to unleash the military on his own people, which would potentially result in thousands of civilian fatalities. Many of the demonstrators had envisaged the birth of a democratic republic based on the Iranian Constitution of 1906. After all, Iran had been the first country in the Middle East and indeed in all of Asia to experience a constitutional revolution establishing a representative parliament. But it was not to be; Ayatollah Khomeini quickly filled the vacuum with his own version of supreme theocratic governance (*velayat-e-faqih*) and the Islamic Republic of Iran was born. Instead of a democratic republic, Iran got a theocracy, a theocracy that many of the Arab family rulers in the region, as well as the secular leader Saddam Hussein in Iraq, viewed (and continue to view) as an existential threat. The rhetoric coming out of Iran only widened the divide.

The region and the world would never be the same. The behavior of the mullahs in Iran so frightened the six sparsely populated countries in the Persian Gulf (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE) that they joined hands to create the GCC in 1981, ostensibly an economic union but in reality a political and military union under Saudi Arabian leadership with American military and political support, as a bulwark principally against clerical Iran and secondarily against Saddam Hussein.

In the heat of the revolution, Iranian students took over the US Embassy (November 1979), and kept 52 American diplomats as

hostages for what turned out to be a long 444 days (until January 1981). This episode had ramifications far beyond the imagination of the mullahs, with implications far and wide and for years to come. Initially, the hostage taking was as an act of rogue students who feared another US intervention in Iran along the lines of the 1953 coup when Mossadeq was arrested and the Shah brought back to the throne. But soon thereafter, Ayatollah Khomeini publicly supported the students and their hostage taking, and as a result the world and the United States saw the embassy takeover in a very different light, namely, as an act of state terrorism. At the same time, the ruling clerics saw the confrontation with the United States as an opportunity to solidify their hold on power (to safeguard their control from revolutionaries who had helped overthrow the monarchy) by portraying the United States as "the Great Satan" and again plotting to undermine the revolution as in 1953. The clerics thus managed to tap into Iranian resentment against foreign interference to solidify their regime.

Very soon after the Islamic Republic was born and the taking of US hostages, in September 1980, Saddam Hussein's forces invaded Iran, precipitating a war that would last until August 1988 to become the longest conventional war of the twentieth century. This was an act of aggression against Iran, plain and simple. Saddam Hussein thought it an opportune moment, with Iran in disarray and hostile US-Iranian relations, to invade Iran and stake his longstanding border claim on the Shat-al-Arab Waterway dividing the two countries—claiming the Iranian shore, as opposed to the middle of the waterway (which has changed course over time), as the border between the two countries. But given the ease of his advance into Iran, his forces went far beyond the waterway into Iran, to nearby oil fields. The UN Security Council did little to condemn Saddam Hussein. Such duplicity would anger Iranians of all ethnicity and creed and sow the seeds of mistrust toward foreigners yet again, affording the mullahs more popular domestic support than they could have ever imagined. Saudi Arabia and the rest of the GCC threw their financial support behind Saddam Hussein as their Arab brother and savior against the revolutionary clerics in Tehran. The United States was silently happy to see the attack and Saddam's success. The Iraqi success did not last, and Iran managed to push the Iraqis out of Iran by the summer of 1982. The United States and the Europeans, afraid of Iran's advance, gave Saddam Hussein internationally banned chemical weapons to defend his country against an Iranian takeover of Basra and beyond. All of this would have long-term consequences for relations in the region and for US-Iranian relations for years to come. During this

war, Iran had only Syria as an ally; Iranians felt threatened by the outside world as never before (the motivating factor for Iran's support of Bashar Assad's crimes in 2011–2013). The people had little choice but to rally around the mullahs in defense of their country. Later, they supported Iran's research into nuclear enrichment as the only viable defense against international aggression. All along, Iran's relations with the Arab countries in the Persian Gulf, especially with Saudi Arabia, were deteriorating, as the Saudis pressed for Iran's demonization and isolation. But this was not all. There would be many unintended consequences.

The Iran-Iraq War disrupted the flow of oil from both countries. Oil fields were damaged, loading terminals came under attack, and shipping and insurance became more expensive. The United States stepped in to protect tankers ferrying GCC (principally Kuwaiti) oil from Iranian threats. But there was plenty of oil available from other exporters to satisfy such shortfalls; moreover the growth in demand had also slowed because of the rapidly rising prices of the 1970s. As a result, oil prices declined dramatically during the 1980s in both real and nominal terms.

The United States had lost its policeman, the Shah, and now embraced Saddam Hussein as his replacement. These events, and especially Washington's embrace of Saddam Hussein, emboldened the tyrant. He had invaded a country with no international condemnation and outrage. He was given internationally banned weapons, which he used to kill thousands of Iranians. There was no international retribution whatsoever. He must have felt that he could do no wrong. There was a clear benefit in having Western, especially US, support. After the Iran-Iraq War had ended in 1988 at a virtual stalemate, Saddam Hussein needed financial resources to keep control of his restive and dissatisfied country. The Persian Gulf Arabs were of some help but he needed more oil revenues at a time when oil prices were depressed. The Kuwaitis had started to exceed their OPEC oil production quota, driving oil prices down further and reducing Iraqi oil revenues. In addition, they produced oil from a disputed oil field near the border with Iraq. Oil production levels and oil field ownership thus became the source of conflict between two Arab countries. On top of this, in a meeting in Jeddah, the Kuwaitis demanded a higher rate of interest on the "loans" it had made to Iraq during its war with Iran. Angered by Kuwait's boldness and confronted with severe resource constraints, Saddam Hussein must have thought that this would be a good time to invade a part of Kuwait (a territory that Iraq had historically claimed) to increase his oil reserves, possibly get

his hands on Kuwaiti financial reserves, erase the notion of a Kuwaiti loan, and gain better physical access to the Persian Gulf now that he could not control the Shat-al-Arab. The United States would surely let him get his way, if not even support him. After all, they loved him! Saddam Hussein even reached out to the clerical regime in Tehran for support and collaboration, but was rebuffed on at least two occasions.

So, in August 1990, Iraq invaded Kuwait and overran the country in a matter of just a few days. This was somewhat a surprise to Arab rulers who believed that an Arab country would never invade another Arab country! Control over oil resources and Kuwaiti financial reserves were the prize, but what must have emboldened Saddam Hussein was America's assumed backing. After all, they had supported him through many egregious acts before. Then came perhaps Saddam Hussein's greatest miscalculation. If he had kept only a part of Kuwait, indications are that he might have been left alone. Not only did he take all of Kuwait, but his armed forces went right up to the border with Saudi Arabia and just sat there! This was stupidity at its worst. Saddam appeared to be on the verge of acquiring the major oil fields of Saudi Arabia. If he had been allowed to do, he would have controlled nearly 40 percent of global conventional oil reserves. Equally important, if he had gained control of eastern Saudi Arabia, he would have made the future landing of foreign troops to liberate Kuwait more challenging. The most senior level of US Central Command personally confirmed the importance of this landing site to me. So while the Iraqis sat there for months doing nothing, the United States planned and transported several hundred thousand troops and an unbelievable array of equipment to Jubail, the port built by American companies in eastern Saudi Arabia.

Another personal digression. In 1991, Iran-Saudi relations had fallen to an all-time low. The two countries had severed diplomatic relations after anti Al-Saud, US, and Israel demonstrations by Iranian pilgrims in Mecca in 1987 had led to the death of two to three hundred Iranian pilgrims and a handful of Saudis. The two governments asked me to intervene and mediate, with the goal of restoring relations. They both had good reason to improve their bilateral relations. Saudi Arabia wanted better relations with Iran because Saddam Hussein was on its borders. Iran was an economic mess and wanted access to external financing. Iran wanted financial grants (gifts) or at least low-interest loans as a sign of Saudi Arabia's remorse for financing Iraq's invasion of Iran, something the Saudis dismissed out of hand. Instead, the Saudis proposed, as a first confidence-building step, close

cooperation between the two countries on oil production and pricing policies. This was a logical offer from Saudi Arabia since oil prices were about $12–14 per barrel and oil revenues had languished since the early 1980s, resulting in budgetary deficits (see below), and reducing in turn the Al-Sauds' financial flexibility. Although this commitment was made at the highest level of the Saudi Foreign Ministry, it was not kept. To their credit, the Iranian side forgave me for this failure. Later I received an apology from the Saudi side. The excuse was that King Fahd had overruled the senior prince and cabinet member's commitment because he did not, and could not, ever trust the regime in Tehran. The King felt that the Iranian regime was intent on overthrowing the Al-Sauds, something that was denied in Tehran by those in the intelligence services, with the most senior member telling me: "The Shah was easy as he had a small family, the Al-Sauds are half the country!" In our opinion, it was also Saddam's crushing defeat that probably emboldened the Saudi rulers. Although Iran and Saudi Arabia subsequently restored diplomatic relations, trust was not, even partially, restored to the level where it had been under the Shah's reign, something that will take serious effort and commitment from both sides for any meaningful improvement. The absence of even a modicum of trust between Iran and Saudi Arabia is an ominous sign for the future of the Persian Gulf. Conflicts are on the horizon and as a result, thousands of US forces are likely to be stationed in the GCC countries and in the Persian Gulf for as long as oil is needed by the world at large and foreign powers support the weaker countries of the Persian Gulf. But what will happen when foreign forces leave?

Thus began the First Gulf War (some refer to this as the Second Gulf War, with the Iran-Iraq War as the first). Arabs had fooled themselves that Arab countries would never attack one another. Saddam Hussein put that wishful thinking to rest. The Kuwaitis and Saudis paid the total US bill. It was the first modern-day mercenary war. The Iraqi forces were destroyed, Kuwait was liberated, Iraq was forced to begin paying reparations, a "No-Fly" zone was established over a part of Iraq, more economic sanctions were imposed on Iraq, and Saddam Hussein was left to rule his decimated and ever more divided country. The United States abandoned its adoption of surrogates in the region. Instead, it firmly established its own footprint in the region, something that it was more willing to do in the aftermath of the Cold War. The US policy toward Iran and Iraq became one of "dual containment" and broad economic sanctions, because the United States did not have many viable options and did not know what else to do. UN economic sanctions hurt the average Iraqi, especially children, while

US sanctions had only a mild effect on the Iranian economy for the 1980s and 1990s until about 2006.

All the while, the transfer and presence of hundreds of thousands of US troops in the region, US intervention in support of the Kuwaiti Sheikhdom, and ultimately in support of the Al-Sauds, and US support for the unelected and oppressive rulers of the GCC became a clarion call for Al-Qaeda recruits. The radicals could now point fingers at those who really propped up their rulers—foreigners and principally the United States. A number, although small by any stretch of the imagination, heeded Osama bin Laden's call to Jihad against the "invaders waging war on Islam."

These conflicts were accompanied by serious costs and financial burdens. The Iran-Iraq War had major economic implications for the two belligerents and some of their neighbors in the Persian Gulf. The cost of the war (in constant 1988 dollars) was $637 billion to Iran, $376 billion to Iraq, and $326 billion to other Persian Gulf countries and the rest of the world, or a total of $1.3 trillion. In contrast to the Iran-Iraq War, the First Gulf War (the liberation of Kuwait) did not have a profound long-term impact on oil prices. But excluding serious environmental costs, the cost (in constant 1991 dollars) to Iraq was $269 billion, $533 billion to the allies, and $34 billion to the rest of the world, or a total of $0.84 trillion. The Second Gulf War turned out to be much more costly and will be taken up in the next chapter. The aggregate cost of the Iran-Iraq War and of the war for the liberation of Kuwait is nearly $2.5 trillion (in 1991dollars), with about $2 trillion of it falling on the Persian Gulf countries, largely on Iraq and Iran and, to a lesser extent, on Kuwait and Saudi Arabia, and Abu Dhabi.[1]

These costs may be better appreciated in context. Prior to the Iran-Iraq War, Iran's oil revenues were roughly $30 billion, while Iraq's oil revenues were around $37 billion. The total cost of the Iran-Iraq War to Iran was equivalent to almost 19 years of Iran's oil export revenues. For Iraq, the war's burden represented 13 years of its prewar oil revenues. Iran's cumulative GDP between 1980 and 1988 was $739 billion (in constant 1988 dollars). Thus, the total damage to Iran's economy during the war was equal to about 77 percent of Iran's cumulative economic output during the war years. Given that Iraq's aggregate output between 1980 and 1988 was $363 billion, its total war-related cost was equal to about 136 percent of its cumulative economic output during the same period. These are staggering costs for Iran and Iraq, with economic implications that are devastating.

The Iraqi and Kuwaiti economies suffered the most damage during the 1991 Persian Gulf War. Given Iraqi oil revenues (before its

invasion of Kuwait) of $15 billion, Iraq would have needed almost 18 years of its prewar oil revenues to pay for the total damage inflicted on its economy. On the other side of the conflict, Kuwait suffered at least $130 billion in budgetary and macroeconomic losses during the invasion and occupation by Iraq. Kuwait also needed 13 years of its prewar oil revenues to cover the budgetary and macroeconomic damage to its economy. If we accept the statement that oil revenues fueled these wars, it is hard to see how oil has helped these countries. But oil, international politics, and Persian Gulf developments are all undoubtedly interwoven and difficult to isolate.

Apart from the direct fallouts for the belligerents, an important secondary effect of the three wars on the region may be found in the composition of government expenditures in the Persian Gulf.[2] In the period between 1989 and 1995, Bahrain's armed forces quadrupled, Saudi Arabia's more than doubled, and the UAE's, Qatar's, and Oman's increased by 50–75 percent. The number of armed forces in other countries—except Iraq and Jordan—either increased or did not change significantly. The result of this far-reaching trend of militarization is the high share of military expenditures in almost all countries in the region. In all of the Persian Gulf countries, the share of military expenditures in total government expenditures from 1990 to 2012 is either higher than or equal to the combined share of public education and health care.

How did the oil market affect events and how did the above events affect the oil market, oil prices, and oil revenues during the turbulent period between 1979 and 2001? Recalling that oil prices spiked in the aftermath of the Iranian Revolution (see appendix in chapter 2) and declined soon after for most of the 1980s and 1990s, with disastrous effects on oil revenues, how did these developments, in turn, impact political and economic conditions in the region, both within countries and between them? How did these shape relations with the outside world, and, in turn, how did relations with the outside world affect regional developments?

Here we must stress one important fact, which we hope will become increasingly evident during the course of this book—oil has been, and continues to be, the single most decisive factor shaping developments in this region and its relations with the outside world. This is not to say that Islam, the foundation and the glue for these societies for nearly 14 centuries, has not shaped developments in these societies, but that oil has played a more direct and all-pervasive role over the last 50 or so years. Oil has made the region important to the world, especially to the United States and Europe after the rapid growth in

demand for oil in the post-World War II period, and more recently to China and other emerging economies. It was because of the expected size of Saudi Arabia's oil reserves that President Roosevelt committed US support to King Abdulaziz. It is oil that has financed vast military expenditures that have so devastated the region in costly conflicts and wars. It is oil that has encouraged rulers to maintain their oppressive rule in order to exact unbelievable wealth for themselves, their families, and their supporters. It is oil that has enabled rulers to buy domestic support at the expense of future generations. It is oil that has given rulers the means to buy expensive foreign support and to do the bidding of foreign supporters—as did Saudi Arabia in financing and providing men (Mujahedeen) for the US effort to fight the Soviets in Afghanistan, or financing the anticommunist forces (Contras) in Nicaragua. And it is foreign support that has reinforced oppressive and unjust rule in the Persian Gulf that has, in turn, resulted in political, social, and economic backwardness all over the region. But as we will discuss in chapter 6, the role of oil has been in violation of Islamic teachings of the Quran. It would appear that for these rulers oil has trumped religion! But for how long?

In 1979, the Iranian Revolution disrupted the flow of Iranian oil, a source of global energy supplies that was more much important in 1979 than in 2012. In 1980, oil prices rose to their highest nominal level ever and were at their highest level in real terms since the 1860s (see figure in the appendix in chapter 2). While oil revenues of the oil-exporting countries had increased in 1973–1974, the higher oil prices had reduced global demand for oil directly by encouraging energy conservation, and indirectly through the economic slowdown (decline in GDP and slower economic growth). Although oil price increases bring about consequences that are temporary in nature (partially reversible with oil price declines), there are also more permanent and irreversible effects—smaller cars, more energy-efficient homes, alternative energy sources, etc. Thus the 1973–1974 and Iranian Revolution price hikes took a heavy toll on demand, encouraged non-OPEC oil production, and stimulated the quest for alternative energy sources.

Accordingly, nominal oil prices fell as dramatically as they had risen; increasing from roughly $14 in 1978 to nearly $38 (in nominal dollars, namely, in dollars of the day) at the height of the disruption in Iran in 1980; falling to about $15 in 1985; and remaining in a narrow range of $11 to $23 during the period from 1981 to 1999. Because of high global inflation, the size of the fall in real oil prices was even more dramatic than the nominal; real prices rose from

$48 in 1978 to $98 in 1980 and then dropped to $28 by 1985 (in 2010 dollars).[3] These price developments occurred during the Iran-Iraq War. Although the war somewhat disrupted the flow of Iranian and Iraqi oil, global supplies were plentiful to meet a demand that had been adversely impacted by previous oil price increases and recessions in a number of countries. Also and importantly, Saudi Arabia increased its oil output in the aftermath of the Iranian Revolution.

The Saudis took credit for what they proclaimed to be a sacrifice, but in reality what they were doing was in their political as well as financial interest. By increasing their oil output, they demonstrated to the United States that they were reliable partners worthy of support. They tempered oil price hikes and thus reduced the revenues of their archenemies, the mullahs in Tehran. As for their financial gains, revenues increased with higher exports, and by tempering oil price increases they protected future demand for their oil. After the invasion of Kuwait in August 1990 and the ensuing Iraq War, there was a short-lived spike in prices, which did not last long because it became quickly obvious that Saudi oil exports were unaffected and Saudi Arabia could make up for oil production shortfalls elsewhere. After the war, the UN imposed sanctions on Iraq. But Iraqi oil was still legally exported to finance a number of UN-sanctioned expenditures, illegally in barges and ships through Iranian waters and by tankers through Turkey. As oil prices dropped in 1981 and stayed low in a narrow range of $11 to $23 in nominal terms until 1999, the revenues of oil exporters declined precipitously and stayed low for about 15 years. And again, because of global inflation, the decline in revenues was much more pronounced in real, as opposed to nominal, terms.

Perhaps Saudi Arabia, because of its heavy consumer subsidies and military expenditures, provides the best case in point of the little appreciation that Persian Gulf oil exporters had, and continue to have, for the depletable nature of oil reserves. How did Saudi Arabia handle budgetary developments as oil revenue increased, jumping with the Iranian Revolution, and then quickly dropping as prices dropped? Saudi revenues and expenditures before and after the Iranian Revolution are shown in Table 4.1.

While oil revenues were the dominant source of government revenues, non-oil revenues, principally interest on external assets and reserves, had also become significant, because Saudi Arabia had accumulated reserve assets through current account surpluses. As we can see, however, by 1983, only two years after recording its biggest budget surplus in its history, Saudi Arabia began running budget deficits.

Table 4.1 Saudi Arabia's government revenues and expenditures

Year	Total expenditures	Oil revenues	Non-oil revenues	Total revenues	Budget balance
1979	49,526	50,479	5,840	56,319	6,793
1980	63,135	85,148	7,679	92,827	29,692
1981	75,907	87,625	10,510	98,135	22,228
1982	65,310	49,602	16,047	65,649	339
1983	61,383	38,699	16,346	55,045	-6,338
1984	57,697	32,359	13,376	45,736	-11,961
1985	49,068	23,580	12,037	35,617	-13,450
1986	36,646	11,324	9,076	20,399	-16,246
1987	49,312	17,975	9,708	27,683	-21,629
1988	37,562	12,907	9,653	22,560	-15,002
1989	41,299	20,240	10,320	30,560	-10,739
1990	55,915	27,026	9,186	36,212	-19,703
1991	74,065	38,653	9,572	48,225	-25,840
1992	63,730	34,344	10,895	45,239	-18,491
1993	50,104	28,260	9,458	37,719	-12,385
1994	43,674	25,468	8,930	34,398	-9,276
1995	46,385	28,194	10,873	39,067	-7,318
1996	52,831	36,262	11,494	47,756	-5,075
1997	59,006	42,663	12,137	54,800	-4,206
1998	50,683	21,333	16,429	37,762	-12,921
1999	49,024	27,853	11,469	39,321	-9,703
2000	62,753	57,180	11,638	68,817	6,065
2003	68,533	61,600	16,53	78,13	9,600
2004	76,053	88,00	16,61	104,61	28,558
2005	92,393	134,5	15,94	150,48	58,096
2006	104,896	161,2	18,45	179,64	74,763
2007	124,3333	149,9	21,49	171,41	47,081
2008	138,68	262,2	31,36	293,59	154,913
2009	159,05	115,8	20,10	135,94	-23,101
2010	174,37	178,7	19,02	197,76	23,395

Source: SAMA (Saudi Arabian Monetary Agency), *47th Annual Report.*

The budgetary deficits were to continue until 2000. These continuous deficits were beginning to threaten the stability of the country. Simply said, the government did not dare reduce consumer subsidies, subsidies that all income classes had come to expect as their right. The decision makers had used oil revenues to finance their own lavish lifestyles and consumption subsidies—cheap electricity, fuel, water, basic foodstuffs, housing, loans, health care, and the like—in order to buy domestic support. Although many of these subsidies were regressive, helping the rich much more than the poor, the average Saudi wanted to enjoy some of the benefits that higher oil revenues could bring, to say nothing of the rising ostentatious lifestyle of the ruling class. The government could not create the productive and high-paying jobs that the populace demanded, so it took the easy way out. That is, it bought the people with subsidies, but subsidies that could not be maintained indefinitely, given the fact that oil revenues would at some point decline to zero. This was a quick way to share the benefits of higher oil revenues, but an approach that could not, and cannot, be sustained for most of the Persian Gulf countries, with the possible exceptions of Qatar, the UAE (Abu Dhabi), and possibly Kuwait.

Another personal digression may reenforce Saudi Arabia's concern with the deteriorating budgetary picture in 1983, a situation that was undoubtedly viewed with some urgency in the Ministry of Finance and the Ministry of Planning (MOP). The MOP of Saudi Arabia (at the time Hisham Nazer was the minister and later went on to become the oil minister, replacing Ahmad Zaki Yamani) decided that Saudi Arabia needed an energy plan based on an integrated world, GCC, and Saudi Arabian energy model(s) to provide estimates for oil prices, oil revenues, sectoral and regional domestic energy consumption by fuel type, domestic refining capacity, and oil storage capacity needs. When this became public knowledge, Oil Minister Yamani went before the King to lodge his protest that the MOP had encroached on his turf. The issue was settled in a compromising Saudi way; the King's office authorized the contract (not either of the two ministries) to be administered by the MOP. I was asked to assemble and direct the international team of energy experts responsible for developing this vast interactive energy model. Interestingly, and with lots of luck, the international part of the model predicted that oil prices would languish until the turn of the century before assuming a strong and sustained upward trend. There was no doubt in our mind that the government was quite concerned about these predictions, but, owing to fears of domestic turmoil, dared not cut subsidies significantly and rapidly.

To be fair, there were enormous pressures on the Saudi government. The princes and the elite wanted a larger share of the oil pie. Their ostentatious lifestyles would have to be accompanied by some benefits for ordinary citizens. The subsidies to the emerging middle class and the poor could not be cut without serious political repercussions.[4] The government was in a financial squeeze. It had no choice but to resort to both borrowing by issuing domestic bonds and borrowing from international banks (syndicated loans) to continue financing expensive consumer subsidies to keep the lid on discontent. However, while it was difficult to cut consumer subsidies, the decision makers found it much easier to slash capital expenditures that enjoyed a much smaller, though powerful, lobby.[5] Over this period of 22 years, Saudi Arabia had surpluses in only five of the years and deficits in 17, with a net deficit of $164.7 billion over the entire period, a deficit that had to be financed by borrowing. Copious oil revenues had financed the consumption of anything and everything, but when the squeeze came it was difficult to stop the benefits the average citizen had come to depend on for survival.

Iran and Iraq were in even worse financial straits than Saudi Arabia because they had engaged in a costly war and had larger populations (with much lower oil revenues per capita). But they had one advantage over Saudi Arabia; they could more easily withhold lavish benefits because they had better control of their population and were more willing to adopt broad and brutal measures against demonstrators and protestors.[6] Only the sparsely populated Persian Gulf countries of Kuwait, Qatar, and the UAE (in reality Abu Dhabi) remained financially strong. In desperate need of revenues, most OPEC countries cheated on their agreed-upon oil production quotas with further downward pressure on oil prices. Not only did OPEC countries simply cheat, the GCC countries (notably Kuwait) cheated with the aim of reducing revenues for their two perceived adversaries—Iran and Iraq. Oil was a political weapon even within OPEC ranks. Oil prices continued to stagnate more or less continuously from 1985 to 2000, with some countries that had spare capacity and were not subject to UN economic sanctions cheating while Saudi Arabia adjusted its oil production level to meet market needs and to keep prices stable (swing producer).

To our mind, OPEC was tested in this period of initially high prices, followed by a long period of persistent low prices. And OPEC failed the test. Yes, OPEC members held emergency meetings to discuss the oil market and to set price targets and individual quotas, but this was largely a façade. Oil revenues are important, but to the

GCC the benefits of higher oil revenues have to be balanced with the impact of oil prices on their two nemeses—Iran and Iraq. There have been short periods of coordination and cooperation. However, much of the time most members did not have any excess capacity, some were under UN or other sanctions, and Saudi Arabia was adjusting its oil output up or down in order to achieve its own political and financial goals. One country acting as a "swing producer" cannot be labeled a cartel.

While GCC countries have attached more importance to political factors than to their own economic viability since the Iranian Revolution, it is more than likely that they have done so at their own peril. Flush with cash, they missed a golden opportunity in the period between 1974 and 1978, during the early years immediately after the Iranian Revolution (1979–1981), and, as we will see, again after the recovery of oil prices in 2003, to create sustainable economies with equal opportunities for all. They will have to provide equal opportunities, good-paying jobs, and equality of benefits derived from oil depletion if they are to avoid future turmoil and revolutions. In the Middle East and the Persian Gulf, it is jobs and especially economic and social justice that matter and will determine which regimes survive and which are overthrown. It is easier to deliver on these when resources are plentiful than when they are scarce.

Because of hostile political rivalries among Persian Gulf countries, to say nothing of ethnic and sectarian divides, OPEC faces divisiveness as never before. Relations between Iran and Iraq on the one hand and the GCC on the other are as bad as they have ever been in recent memory. For the GCC, economic failure and backwardness in Iran and Iraq has appeared to be a more important goal than their own domestic conditions, to say nothing about OPEC cohesion. But *Schadenfreude* will come home to roost! The GCC countries may feel more secure than in the past, because their cash hoard has grown. Iran has become more isolated and the GCC countries' excess oil production capacity (and the financial means to increase their installed production capacity) within OPEC gives them more leverage with the United States and Europe in a world that is increasingly concerned with global warming (namely, opposition to coal) and nuclear power safety. But for how long as the output of oil from shale and tar sands, shale gas, and renewables grow in importance?[7]

Turning again to the oil market, while Iraq may be able to increase its installed capacity significantly over the next ten years to rival Saudi Arabia, it needs political stability and investment in its oil industry. Much of this investment, to the tune of $300–400 billion, would

have to come from abroad. The central government in Baghdad also has problems with the Kurdish region's independent oil policies. In January 2013, it even appears that Turkey might further feed this tension by making its own oil deal with Iraq's semiautonomous Kurdish region. Iran could also expand its oil capacity somewhat, repair its existing fields, and increase its natural gas output to rival Qatar's if it could achieve a measure of economic prosperity, shed economic sanctions, and attract vast inflows of capital. For now the GCC rules and OPEC cohesion is a mere façade, with Iran and Iraq as the enemy. OPEC's major successes may have been during the years between1969 and 1974, and its heyday may effectively have been over by the early 1980s, with OPEC becoming irrelevant thereafter. For the foreseeable future, OPEC is a gathering point to talk, with little relevance for the oil market.

It is the GCC and Saudi Arabia that matter today in 2013, and for them political survival is the factor that is paramount. GCC rulers will sacrifice OPEC and everything else for assured foreign support to hold on to power, which in turn also means anything that brings about what they would consider favorable regime change in Iran and Iraq. Whenever OPEC solidarity is at issue, one asks whether unilateral action by one or more OPEC countries might be a weapon? It would depend on prevailing market conditions. Namely, if oil markets were generally tight, or tight for a particular grade of crude, then whether unilateral action would be effective would depend on the level of available excess capacity around the world and the level of strategic reserves. If existing excess capacity (and strategic reserves) were 1 MBD, then any country whose exports exceeded something over 1 MBD could cause havoc in the market, and the more the havoc the larger the country's exports. In 2012, Saudi Arabia or Russia alone could bring the world economy to a halt, as could a combination of two other OPEC members among the major exporters. In 2012, Iran and Iraq together could do the same, and even more so in the future because their market share is likely to increase. These could be ominous signs for the oil market and, in turn, for a peaceful Persian Gulf, for the broader Middle East, and for the future of the global economy.

Summary

OPEC came to global attention in 1971 (Tehran Agreement), in 1973–1974 (during the Arab Oil Embargo and the ensuing shortages and oil price increases), and in 1979 during the Iranian Revolution,

with perhaps the most dramatic spike in oil prices. Although in 1971 it was generally recognized that the tightening oil market—OPEC's growing share of global oil production and exports—was the underlying reason for price increases, in the latter two periods the price increases were attributed to disruptions and incorrectly, in our opinion, to OPEC production management and cutbacks. In effect, price movements have had less to do with OPEC unity than with sudden or gradual market supply-demand developments.

In the aftermath of the Iranian Revolution and the Iran-Iraq War, a period that saw disruptions to the flow of Iranian and Iraqi oil, the major and prolonged decline in prices was due to changed market conditions. OPEC could do nothing to prop up prices in the face of dramatic changes in global energy supply and demand. Moreover, major OPEC members, principally the GCC led by Saudi Arabia in the one corner and Venezuela and Algeria led by Iran in the other corner, had little or no political reason to coordinate their oil production policies. OPEC was more of a façade than an effective cartel. The political differences among members may become even more pronounced in the future, with the GCC camp on one side and the Iran-Iraq camp on the other. For Saudi Arabia, oil pricing and production policy are closely tied to international and regional political realities as well as what prices will do to the long-term demand for their vast oil reserves. For Iran and Iraq, in desperate need of oil receipts, it is short-term revenues that are of paramount importance. The only possibility for cooperation and coordination in the foreseeable future would rest on dramatic changes in the political structure of Iran, Iraq, or Saudi Arabia, or on the majority of OPEC members facing serious financial crises that threaten the survival of those in power. In 2012, political considerations may be perceived as a more important determinant than oil revenues for the survival of a number of rulers. Under these circumstances, the impact of OPEC actions on prices may be largely inconsequential. Indeed OPEC's time as an effective organization may have passed with the Iranian Revolution, if not earlier in 1975.

Although there was a dramatic recovery in oil revenues after 2000, the lessons of the period between 1983 and 2000 should not be forgotten. Oil prices and revenues can drop as quickly as they rise. If revenues are wasted in times of plenty, then governments may have little choice but to borrow to finance consumption subsidies to keep the general citizenry at bay. But for how long? Moreover, deficits may reduce their ability to buy foreign support, be it through major contracts, arms imports, or though direct payments for services. Most

importantly, the lesson of the 1980s and the 1990s is that the ongoing policies of most major oil exporters in the Persian Gulf (with the possible exception of the very rich, namely, Qatar, Abu Dhabi, and Kuwait) are unsustainable. The sooner they make radical changes, the easier it will be for their survival. If they change now, while revenues are still bountiful, they may be able to keep their domestic constituencies content, buy foreign support, and stay in power. But as we shall see, they will need political as well as economic reform to be successful in the longer term.

Chapter 5

Oil—The Most Recent Years (2001–2013)

In our view, the CIA-engineered ouster of Mohammad Mossadeq in 1953, although a regional event, was one of the two (the collapse of the Soviet Union the other) momentous events of the second half the of the twentieth century; an event that changed the course of Middle East history and had the most significant impact on Middle East-global, especially Middle East-US, relations. The terrorist attack on September 11, 2001 against the United States by Al-Qaeda, aka 9/11, could turn out to be the momentous event of the first half of, or even of the entire twenty-first century. As in the case of Mossadeq's ouster, 9/11 has led to a number of important and hard-to-predict events, especially in the United States, in the Persian Gulf region, and around the world that, in turn, may have consequences far beyond our imagination today and for years to come.

The immediate reaction to the horrific events of that September day included disbelief, shock, and anger in the United States. Around the world, there was an outpouring of solidarity with the United States. Yes, there were some Al-Qaeda sympathizers, but they were few and far between. Yes, the attacks did impact the US economy, but the more profound economic impact was to follow in the form of two wars, budgetary deficits, and fiscal pressures that reduced the US government's room for maneuver in the face of the most serious economic crisis (the financial crisis of 2007–2008) since the Great Depression of the 1930s, and the effective redrawing of the Persian Gulf map through the installation of a Shia regime in Baghdad.

The events of 9/11 cemented US hegemony in the Persian Gulf. As we have already stated, following World War II the United States gradually replaced Britain in the region. Although the United States

had given its support to the Al-Sauds following World War II, beginning in the late 1960s and especially in the early1970s the United States, to the dismay of the Al-Sauds, adopted the Shah of Iran as its surrogate and as the effective "policeman of the Persian Gulf." After the Shah's fall from power, the US mantle temporarily fell on Saddam Hussein. But after Saddam Hussein invaded Kuwait and threatened Saudi Arabia in 1990, the First Gulf War fully established US hegemony in the Persian Gulf, with continued US military presence in the region. This hegemony became a national necessity for the United States after the 9/11 attacks, for both national and oil security.

In the immediate aftermath of 9/11, however, US-Saudi Arabian relations became strained. There were 15 Saudi citizens among the 19 terrorists, and a twentieth (missing) terrorist was also a Saudi. All 19 terrorists were trained by Al-Qaeda, which was financed by Osama bin Laden, a Saudi citizen who had close family connections with the Al-Sauds. Recall the fact that the CIA had worked with Osama bin Laden and Saudi intelligence services a numbers of years earlier to train and arm Mujahedeen to fight against the Soviet Union in Afghanistan, volunteers who were overwhelmingly from Saudi Arabia. These were the same Saudis who terrorized the United States on its own turf a number of years later in 2001. This was not the only terrorist attack attributed to Saudis; others would follow. Popular sources alleged that Saudis were the major financiers of Madrassas that propagated the Wahhabi-Salafist message of hatred and of anti-Western Muslim radicalism around the world. A variety of polls indicated widespread anti-American sentiments among Saudi citizens. Given these circumstances, if the country had not been Saudi Arabia, but Iran or Iraq, or for that matter a number of other countries in the region, the United States might there and then have severed diplomatic relations, imposed economic and political sanctions, and even contemplated military action. But this was Saudi Arabia, the country with the largest oil reserves in the world, a compliant US ally, and a country with a ruling family that President Roosevelt had agreed to protect in exchange for preferential access to oil. Still, the American public became angry with the Saudis, Congress took up hearings on US-Saudi relations, religious and education policies in Saudi Arabia were scrutinized and attacked in the American media, and it became more difficult for Saudis to get visas for the United States. All the while, President George (Walker) Bush turned his attention to Afghanistan and Iraq, with politicians pointing fingers even at Iran, which had absolutely nothing whatsoever to do with the events of 9/11.

After the 9/11 attacks, the United States took no military or even strong political action against Saudi Arabia. Instead, in October 2001, the United States, with principal backing from the United Kingdom, bombed Taliban and Al-Qaeda strongholds in Afghanistan, while the Northern Front, or Northern Alliance, inside Afghanistan took over much of the country in partnership with the United States and the United Kingdom. After the Northern Alliance had driven the Taliban and Al-Qaeda into hiding, the allies then invaded the country, with the goal of destroying the Al-Qaeda network and replacing the Taliban, who had supported and provided a safe haven for Osama bin Laden. The NATO operation was named "Operation Enduring Freedom," with the principal fighting force named the International Security Assistance Force. Nine NATO allies provided more than 1,000 troops each and another 22 provided troops in the range of 150 to 1,000. A number of other countries, including a few Muslim countries, also provided some troop and material assistance. But the main force was provided by the United States, with the United Kingdom as a very distant second.

In some ways, Muslims around the world saw this as a "just" war (as much as any war can be called just). The United States was responding to an unprovoked attack on innocent civilians on its own soil. The attack had come from Al-Qaeda. Osama bin Laden was holed up in Afghanistan, with Taliban protection. But what happened two years later in 2003 would come to be seen in a totally different light. On March 20, 2003, without any provocation or declaration of war, the United States and the United Kingdom invaded Iraq. The United States and its Western allies had earlier, after the liberation of Kuwait, watched as Saddam Hussein massacred thousands of Shias in the south of Iraq, but now, with no provocation, there was to be war. The entire premise for this invasion was that Saddam Hussein possessed weapons of mass destruction (WMD) that posed a threat to the national security of the United States and the United Kingdom. There was no evidence to support this claim and no WMD were ever found in Iraq. Ironically, if any such weapons had been found, their origination would have been western Europe and the United States. In contrast to the invasion of Afghanistan, this war was perceived by a large number of disenfranchised Muslims under oppressive rule as an attack on Islam. The invasion of Iraq was quick and relatively painless for the United States. Iraqi resistance was less than expected, Baghdad was taken on April 9, the major conventional military actions were largely over by mid-April, Saddam Hussein was captured in December 2003, and his 24-year rule was brought to an

end. While the conventional warfare ended quickly, a war of insurgency escalated and continues, though at a much-reduced level, even in early 2013. The war left hundreds of thousands of Iraqis dead, injured, and homeless. The United States lost about 4,500 troops and had another 30,000 injured. For the United States the war formally ended on December 15, 2011, but there are still over 4,000 US military advisors stationed in Iraq in early 2013.

Under Saddam Hussein and even earlier, a Sunni minority had dominated a Shia majority of some 60–65 percent. With the US invasion, it was clear that the Shia would come to power. A number of the Iraqi Shia leaders had lived in Iran for years and had close connections to the clerics in Tehran. In the build-up to the invasion, the Al-Sauds had become nervous about what was about to happen, but their pleadings fell on deaf ears in Washington, and the Al-Sauds' worst nightmare came true with the installation of a Shia regime in Baghdad. The Al-Sauds saw, and see, the Tehran-Baghdad axis as an existential threat, and so, to show their displeasure at US policies, they have supported the Sunni insurgency in Iraq (an insurgency that has killed and injured thousands of American soldiers and military contractors) and refused to establish an embassy or nominate an ambassador to Baghdad. They have further shown their annoyance with the United States by turning to the United Kingdom for some major defense purchases. Their stance against the regime in Baghdad, especially their support for the insurgency, has been the major source of American fatalities and injuries in Iraq and a major thorn in the American side. Yet relations between the countries have improved significantly from their nadir in the aftermath of the 9/11 attacks, because the Al-Sauds need US protection against what they will perceive for the foreseeable future as a Shia threat, and the United States needs Saudi cooperation on oil policies and as a foothold against Iranian threats in the Persian Gulf.

Although the Al-Sauds must maintain US support to stay in power, as an insurance policy they will also do whatever they can to undermine the regimes in Iran and Iraq so as to disrupt the cooperation between the two largest Shia powers in the region. The Al-Sauds also perceive a Shia threat in Bahrain (65 percent Shia) and from their own 12–15-percent Shia population, especially in the event of Iranian-Iraqi cooperation and resurgence. All of this would become a veritable nightmare for the Al-Sauds if the United States withdrew from the Persian Gulf. As a result, Saudi Arabia has intervened in Bahrain in support of a brutal suppression of basic Bahraini human rights. Saudi forces have killed demonstrators in the Eastern Province of

Saudi Arabia. Saudi Arabia has supported the Sunnis and Christians in opposition to Iran-backed Hezbollah in Lebanon. The GCC has come out strongly in support of the opposition Sunnis fighting to overthrow the brutal Iranian-backed Bashar Al-Assad in Syria. Under the prevailing conditions in 2013, to say that relations in the Persian Gulf are hostile and in a state of turmoil would be a historic understatement. What is clear is that US-Saudi interests converge on a number of these regional issues and diverge on others (in particular Saudi antagonism toward the Shia regime in Baghdad). The relationship is not as simple as it was when President Roosevelt and King Abdulaziz signed their agreement regarding US protection of the Al-Sauds in exchange for preferred access to Saudi oil. In 2013 there are many more dimensions to the relationship. Though the relationship has been strained, both sides continue their cooperation because they will need each other for at least a decade or two.

The Iraq War took a heavy financial toll on the United States and on Iraq. The total cost inflicted on the direct belligerents, neighbors, and the rest of the world is estimated at $2,509 billion, $140 billion, and $531 billion, respectively, for a total cost of almost $3.2 trillion (in 2011 constant dollars). The war has inflicted severe budgetary pain on the United States, perhaps for the first time since the Vietnam War. More than half of the total estimate for the global cost of the war was and will be incurred by the United States—a figure exceeding $1.7 trillion. Moreover, the human cost for the United States has been unmatched since the Vietnam War.[1]

Apart from the direct losses to the belligerents, another economic effect of the three recent wars in the region may be in the composition of government expenditures in the Persian Gulf.[2] According to World Development Indicators (the World Bank), in the period between 1989 and 1995, Bahrain's armed forces quadrupled, Saudi Arabia's more than doubled, and the UAE's, Qatar's, and Oman's increased by 50–75 percent. The number of armed forces in other countries—except Iraq and Jordan—either increased or did not change significantly. The result of this far-reaching trend of militarism in the region is the high share of military expenditures in almost all countries in the Persian Gulf. In all of them—except in Iran, where the quality of data, especially for military expenditures, is highly disputable—the share of military expenditures in total government expenditures are either higher than or equal to the share of public education and health care combined during the years between 1990 and 2009. Add to these facts and figures the recent $60 billion arms sales contract announced between Saudi Arabia and the United

States,[3] the UAE's $7.1 billion contract to purchase 80 of the most advanced F-16 fighters in the last decade,[4] the recent $35 to $40 billion contract with the United States to purchase and upgrade the UAE's anti-missile defense systems, Oman's $12 billion and Kuwait's $7 billion contracts with the United States to buy new warplanes,[5] and Washington's reported agreement to sell bunker-busting bombs to the UAE.[6] This is a breathtaking set of numbers that no country can afford, let alone countries that are, and continue to be, largely dependent on a depletable asset—oil.

A revealing fact about the region's military expenditures, conflicts, and wars is that almost all Persian Gulf countries are trailing the OECD, the world average, and other developing countries when it comes to public spending on health care as a percent of GDP. While it is widely accepted that long-lasting economic and human development requires emphasis on health care and especially on education, the Persian Gulf countries seem to be going in the opposite direction. These wars did not only inflict heavy budgetary and macroeconomic damage on direct belligerents and on other countries in the region, they have had a major role in turning the Middle East into the most militarized region in the world over the past three decades.[7] The future is not bright, because conflicts beget conflicts, unless leaders in the region can adopt bold measures such as those in Europe in the aftermath of World War II. These are staggering costs that all Middle Easterners must be made aware of, costs that are a testament to the folly of their leaders and the duplicity of the powerful nations, who back different sides to conflicts and supply them with lethal weaponry. The question concerning the impact of oil on the region that must be answered is simple: would these wars have occurred and with such devastating destruction if there were no oil to fight over and no oil to finance the most lethal conventional weaponry known to man?

Another important development of regional hostilities has been Iran's quest for nuclear enrichment, claimed as peaceful by the mullahs or as a step toward nuclear warheads by the United States, western Europe, and the GCC. Whether Iran's program is peaceful or not, only a few in Iran would know. In any case, Iran's continuing enrichment program has triggered a tightening of US, UN, and European Union (EU) economic sanctions. But the quest for enrichment can be explained as Iran's response to its isolation during the Iran-Iraq War (see appendix 1 to this chapter for some details). The US economic sanctions on Iran that were adopted after the hostage taking and modified for the next 30 years had little effect on Iran. They were reenforced by UN sanctions. Still, the economic sanctions

were porous until 2008 after Stuart Levey, who had taken over the Office of Foreign Assets Control, began to tighten the screws on Iran in 2004. The US Treasury adopted a number of financial initiatives that started to impact Iran's revenues and its ability to protect its financial reserves (see appendix 2 to this chapter for more detail). These measures were further reinforced when western Europeans (the EU) signed on to some of these sanctions. Later in 2012, US and European sanctions on Iran's oil exports further squeezed the Iranian economy. Although sanctions started to bite Iran beginning about 2008, and especially in 2012 with enhanced financial and oil export sanctions, Iran's overriding economic problem has been its own prolonged economic and financial policy mismanagement. Iran's reduced oil exports, cut roughly by 40 percent in October 2012 over what they had been earlier in the year, had little effect on oil prices.

More generally, how did oil prices behave in the period between 2001 and 2012? What effect did events have on oil prices and on Persian Gulf oil revenues? How did revenues affect political and policy developments in the region and how did regional politics affect oil production policies?

Oil prices changed little in response to the 9/11 attacks or the invasion of Afghanistan, but started a steady rise beginning in 2003 (in part due to the Iraq War) and especially beginning in 2004. Average oil prices rose about 20 percent in 2003, to an average of about $30 with the onset of the Iraq War. The price increase (in nominal or the day's dollars) accelerated in 2004 to $40 and then to above $50, rising to above $60 in 2005, and to over $75 in 2006; in early 2007 prices fell temporarily to about $60 but then rose rapidly in the balance of the year to nearly $100. In July 2008, prices raced to nearly $150; they fluctuated widely for the balance of the year and later in the year, with the onset of the financial crisis, fell to below $60. In early 2009, prices fell to below $40 with the severity of the financial crisis, the ensuing great recession, the recognition of the euro crisis, and the global economic slowdown. Since 2009, prices have fluctuated largely in the $80–100 range.

As we have said a number of times, like anything else oil prices are determined by the interaction of supply and demand. How have supply and demand behaved during the period from 2001? During the period between 2003 and 2008, the main drivers of steadily rising oil prices were rapid economic growth, especially in emerging market economies, and reduced oil output outside of OPEC member countries; China's oil consumption increased from 228 million tons in 2001 to 376 million tons (or a 53-percent increase in just seven

years), while global consumption increased from 3,595 million tons to 3,987 million tons (or only 11 percent over the same period). Besides the basic forces of supply and demand, a number of related factors have been proposed as important determinants of oil prices. Some have stressed the role of monetary policy, and in particular the US Federal Reserve, others have focused on the role of speculation, and still others have linked oil prices to the exchange rate of the dollar.[8]

All in all, the combination of rapid increase in world oil demand and rising bottlenecks in oil supplies outside of OPEC fueled dramatic oil price increases over the period 2003–2008, the most prolonged boom in OPEC history, but with wide fluctuations and volatility driven by speculation, exchange rate movements, and political events. The boom in oil prices, in turn, led to unprecedented current account (net transactions with the rest of the world) surpluses and financial reserves at historic highs for Persian Gulf countries. While the oil market is tight in 2013, with only Saudi Arabia, followed by the UAE and Kuwait, having any significant excess oil production capacity, even Saudi Arabia does not have the ability to move prices significantly downward (producing and exporting much larger quantities of oil), but only upward (cutting output). To our mind, Saudi Arabia's market power will likely decrease further in the coming years, with predictions that the United States will become an exporter of crude oil in about a decade or so.[9] Thus the Roosevelt-Abdulaziz Al-Saud agreement may come under increasing strain as the Al-Saud's end of the deal becomes less important to US interests and Saudi policies become an embarrassment to US support for freedom and democracy around the world. Why will Saudi Arabia's importance in the global oil market decline?

We have long believed that the oil market position of the Persian Gulf region will go through a fundamental transformation. First, we, unlike some others, have not and do not see the region's global oil market share increasing significantly in the coming years. We believe that unconventional oil (shale and tar sands) and oil from the Arctic and the very deep sea will make important contributions to supply; oil demand will not grow as fast as most expect both because of much slower global economic growth over the next five to seven years and because of more conservation, especially in the United States and in most emerging markets where the biggest growth in demand has been expected; the relative contribution of natural gas, even in transportation, will continue to increase; shale gas will steadily become a major fuel source worldwide; and renewable energy will make a bigger contribution than most project, with solar energy becoming increasingly competitive as the price of solar panels continues to plunge. As

important, we think that Saudi Arabia's significance in the global oil market is just about at its peak in 2013–2014; it will start to decline in the next decade or so as Saudi Arabia's domestic oil consumption continues to increase rapidly, its production capacity is near its maximum, and the production of oil in other countries in the Persian Gulf increases. Although Iraq will continue to be besieged by insurgency and instability, we believe that a new group of corrupt officials, looking out for their own quick financial gains after years of Baathist rule, will offer increasingly attractive terms to international oil companies and investors, which will, in turn, boost Iraq's production capacity and enhance its proven reserves well beyond the 200 billion barrel-level and approaching Saudi Arabia's level of reserves. In Iran, we expect a major boost to Iran's natural gas output (and a significant increase in oil output capacity), destined for domestic consumption and export, especially to Europe and southwest Asia. Still, oil price shocks may become even more pronounced because of gaping ethnic and sectarian divides in the region, increasingly unpopular Persian Gulf governments, US support for oppressive rulers, and the resulting interstate and intrastate insurgencies and conflicts.[10]

As we have said above, the importance of Persian Gulf and Saudi oil will decline for the United States. As a result, the United States, which gradually replaced the British in the Persian Gulf following World War II and dominated the region after Saddam Hussein's invasion of Kuwait, will begin to gradually reduce its footprint in the region; while a resurgent China that requires access to raw materials, especially oil, tiptoes cautiously into the region. The Saudis and the GCC will lose the strong military backing of their superpower. Politically, we believe that the Al-Sauds will feel increasingly threatened and will show a tendency to circle the wagons. They will push for an enlarged GCC that includes Jordan, Morocco, and Yemen, and a more unified GCC under their stewardship, with unified military, intelligence services, foreign policy, religious affairs, and currency (single or common), with Saudi fiscal support for Bahrain and Oman (and Jordan, Morocco, and Yemen if they become members), and with more financial assistance from Abu Dhabi for the poorer members of the UAE. Simultaneously, Saudi Arabia will step up its support of Iraqi Sunnis and Lebanese Sunnis and Christians (in opposition to Iranian-backed Shia under the umbrella of Hezbollah). Instead of adopting fundamental political and economic reforms that could ensure their survival for decades to come, they will opt for a reactionary response that will compromise their economic future and lay the foundation for future conflicts and will not serve them well in

the longer run, especially after the United States begins to move out of the Persian Gulf as it increases its footprint in East Asia.

But economics will continue to be important to all the Persian Gulf countries, especially for Iran, Iraq, and Saudi Arabia. Given the continuing turmoil in Iraq and the economic sanctions and isolation of Iran, it may be most indicative to see how Saudi Arabia has fared during the oil price recovery starting in 2003.[11] When oil prices rose during 1973–1974 and especially during 1979–1981, Saudi Arabia went on a spending spree and quickly started to run deficits. What did Saudi Arabia do differently after prices rose in 2003? Looking at the numbers in Table 4.1, it would appear very little.

As oil prices and revenues rose, Saudi Arabia increased its expenditures. Some went to capital projects to create new industrial cities and stimulate private sector business activity. But some of the increased revenues were used to support consumer subsidies in the face of high unemployment and popular dissatisfaction with economic inequalities and performance. Most distressingly, and as pointed out earlier, military expenditures increased significantly, with major long-term contracts with the United Kingdom and the United States. The record and massive surplus of 2008 became a deficit in the following year of 2009. It would appear that oil revenues continue to drive expenditure policies, but with little attention to the depletable nature of oil. Oil revenues continue to be used as they have been in the past—to buy domestic support, to buy foreign support through military expenditures, and as we shall see, in Part II of this book, through other business contracts with foreigners, and to suppress domestic demonstrations in the name of stability. The depletion of oil has not brought about sound policies to replace oil as a source of income, but has instead enabled the suppression of public discontent, bought short-term allegiance, and above all has afforded the means to keep a tight hold on power as the preferred method for survival with ominous implications for the future. But rulers in Saudi Arabia, and in the other countries of the Persian Gulf, neglect the importance of sustained economic prosperity, jobs, and economic justice at their own peril.

Summary

The period between 2001 and 2013 has been, and may continue to be for some time, the longest era of high and sustained oil prices and revenues for the oil-exporting countries of the Persian Gulf. It has also been a period of dramatic political change in the region and in the broader Middle East: the widespread consequences of the 9/11

attacks; the toppling of the Baathist regime in Iraq and the rise of a Shia government in Baghdad; the war in Afghanistan, violent regime changes in Egypt, Libya, Tunisia, and Yemen; civil war in Syria; the violent suppression of popular demonstrations in Bahrain; demonstrations in Kuwait and in the Eastern Provence of Saudi Arabia; popular demonstrations that turned violent against election fraud in Iran; perceived threats of Iran's nuclear enrichment program; tightened UN, US and European sanctions on Iran; violence in the Kurdish regions of Syria, Turkey, Iran, and Iraq; and the continued presence of a large contingent of US forces in the region.

Oil has been a factor, directly or indirectly, in all these regional developments, and these regional developments have, in turn, affected oil policies in the region. While on one level the landscape of the region has dramatically changed over the last 50 or so years since the formation of OPEC, on another level it would appear that little has changed. Oil revenues are still wasted. The economic and financial foundation for post-oil economies has not been established. Social and economic justice is a mirage because oil revenues continue to benefit the few, with ominous implications for future generations. Sectarian, ethnic, and tribal divisions continue to grow as conflicts ravage the region. Most depressing in this regard are the growing Shia-Sunni divide and the Saudi-Iranian split. These conflicts will only grow and spawn other conflicts unless reconciliation and reforms take root. Oppressive rule continues to be the norm. Political reform is a mirage. Effective institutions, especially the rule of law, are but a dream. Without simultaneous economic and political reform the region will be in a state of continuous turmoil, with no hope of an economic turnaround. In the absence of an economic turnaround, conflicts and wars to grab oil and gas resources could be the region's destiny. The window of opportunity afforded by oil may close—with declining oil revenues—in the next 15–20 years if it remains unaccompanied by positive change and development.

In the second half of this book, we hope to further explore the economic and political manifestation of oil to determine how the political economy of oil can be changed to benefit the region's long-term prospects.

Appendix 1: Iran's Quest for Nuclear Enrichment

Iran's nuclear ambitions have dominated US-Iran relations since 2000. The United States has argued that Iran does not have the right to enrich uranium, that its enrichment program is only a cover for the development of nuclear weapons, and that Iran is in violation of the Treaty on the Non-Proliferation of Nuclear Weapons (NPT). Iran has argued that its enrichment effort is peaceful, that it is in compliance with the NPT, and that unlawful abrogation of Iran's rights will not stop its efforts. Let us begin by giving some essential background to the appreciation of Iran's nuclear quest.

Under the NPT, one of the two significant inducements to signatories is the promise of access to peaceful nuclear technology, including enrichment and heavy water reactors. The understanding was that signatories would disclose all their nuclear activities. Iran failed to disclose all of its activities. Iran claims that disclosing its peaceful enrichment activities would have led to the voiding of its rights under the NPT even earlier. Ironically, developments seem to support this Iranian assertion. The United States argues that given the nature of the regime in Tehran and because the regime failed to disclose its activities, Iran has lost its right to enrichment. From a legal standpoint Iran has not technically violated the NPT. Moreover, the nature of the regime in Tehran is totally irrelevant under the NPT. Countries, not governments, have rights and obligations and these are unaffected by changes in government. Simultaneously under the NPT, signatories could expect the support of the International Atomic Energy Agency (IAEA) for safeguards and other assistance in their quest for peaceful reactors. The Board of the IAEA denied Iran's request for such assistance for its heavy water reactor in Arak on November 23, 2006. The key points are whether Iran has the legal right to enrich and to develop heavy water reactors. The answer is yes on both counts. The other major inducement to signatories of the NPT was that the nuclear

powers would reduce and eventually eliminate their own nuclear arsenals. Have the declared nuclear powers, especially the United States, fulfilled their end of the bargain under the NPT? The answer is no. They have either been slow to reduce their arsenal or have increased it; indeed, the United States has been developing new classes of nuclear weapons and some powers continue to test their nuclear weapons.

In the meanwhile, India and Pakistan have acquired nuclear weapons outside of the NPT. While they were initially slapped with sanctions, both countries are now given support by the international community. The United States seemingly embraces India's nuclear weapons program, having signed a nuclear cooperation and development agreement (during the Presidency of George Bush) that will allow India to accelerate its weapons program. Pakistan receives more economic support than ever before, a fact that is very difficult for Iranians to swallow. Why? Remember that Pakistan was the main supporter of the Taliban, a conveniently forgotten fact in Washington. At the same time, Israel is estimated to have at least two hundred nuclear weapons. Western, and especially US double standards have not escaped Iranian scrutiny. In the face of these developments, Iran and, more importantly, Iranians feel insecure, victimized, and bullied.

What does bullying and plotting against Iran achieve, especially when done without clear legal grounds? The answer is very little that is positive. Iran has not forsaken its nuclear program. It is likely that Iran has or will accelerate its efforts outside the IAEA monitoring structure. The flaunting of legal rights will only undermine the UN. The adoption of the UN's financial sanctions, which are clearly at odds with the IMF Articles of Agreement, will undermine the international financial system. The price for these shortsighted policies will be paid in the future. The world can only look forward to more regional conflicts as countries are forced into isolation, and the likelihood of nuclear mishaps increases, given the fact that Iran and others will not benefit from IAEA technical support. If Iran is threatened further, one could expect the Iranian people's increased determination to develop nuclear weapons and not just nuclear power. Why the potential quest for nuclear arms? Just look at Iran's recent history, and especially its relations with the United States.

Iran and Iranians (and not just those who oppose the mullahs) feel more insecure than at anytime since World War II. Acquiring an integrated nuclear power (not weapons) program may be the only way they can get the security they seek because it would enable them to develop a deterrent in case of imminent threat. Where does this sense of insecurity come from? Recall that the United States and the United Kingdom overthrew the constitutionally elected government of Iran in 1953. Iraq's invasion of Iran in 1980 along with the West's

subsequent support for Saddam Hussein fueled Iranian unrest and affected Iranian attitudes toward the West, and especially toward the United States. The acquisition of nuclear technology (that could lead to the development of nuclear arms if necessary) is an increasingly popular policy in the eyes of the average Iranian. The world must understand Iranian motivations if it is to dissuade Iran from acquiring nuclear arms. We believe that for Iran the right to an integrated nuclear power program including enrichment may be nonnegotiable.

After Saddam Hussein invaded Iran, the UN and the West took no serious diplomatic actions against Iraqi aggression, thereby failing to uphold the international rule of law. The reasons for this were clear: on November 4, 1979, Iranian student militants had attacked the US Embassy in Tehran and 52 Americans were taken hostage, a crime that was later sanctioned by Khomeini. Western presumptions of Iranian religious expansionism were another factor in the West's support of Iraq at that time. During the course of this bloody eight-year war, Saddam Hussein used US- and European-supplied biological and chemical weapons to kill and maim Iranians in the thousands, while the West embargoed the sales of even conventional weapons to Iran and supplied Iraq with all its needs, including satellite intelligence from the United States. The result was that over 500,000 Iranians died and even more were injured, with many permanently disabled from biological and chemical weapons. Average Iranians, not just the mullahs, painfully learned what it was to be vulnerable to external aggression. The UN and international agreements did not provide peace of mind to Iranians. The undermining of the international rule of law has consequences, although not always immediate.

Then came the First Gulf War. While Iran played a positive role, not only did it not receive any recognition, it was excluded from the ensuing regional US-sponsored security arrangements that included even far-away Egypt. Iran did not receive any war reparations from Iraq. The United States further alienated Iran by opposing Iranian participation in Caspian Sea oil development, especially the construction of pipelines through Iran and oil swaps (Caspian oil for Iranian oil refineries in northern Iran for Iranian oil in the Persian Gulf). Finally US economic sanctions on Iran were further tightened.

The First Gulf War was followed by the US-led invasion of Afghanistan on Iran's eastern border roughly a decade later. Iran, the country that had supported the Northern Alliance throughout the Taliban rule and had accepted over two million refugees, had another opportunity for quiet rapprochement with the United States and the rest of the West. Iran was especially optimistic, given that the Northern Alliance was the main indigenous fighting force. Again Iran was to be disappointed.

Iran received no positive recognition and was instead labeled a founding member of the so-called Axis of Evil by the President of the United States, further alienating average Iranians (not just the mullahs) and making them feel less secure. During the second invasion of Iraq by US-led forces, Iran did not appear to interfere to the degree it could in Iraqi affairs, especially in the Shiite south where it had significant influence. But again, the rhetoric against Iran continued.

A United States that has not upheld the rule of law, reserves the right to overthrow regimes, does not follow the Geneva Convention, and has been belligerent toward Iran now surrounds Iran on all sides. Can ordinary Iranians be blamed for feeling insecure? While many, or even the majority, of Iranians may not support the mullahs who oppress, torture, jail, and kill dissidents, Washington's record around the world and in the region hardly inspires confidence. The massive US presence in the region only raises anxiety, as evidenced by the results of numerous polls conducted in Muslim countries of the region. The US approach has not only stiffened the regime in Tehran, but has motivated Iranians to defend what they see as their dignity and their rights as an independent nation. A major source of legitimacy for the regime in Tehran in the eyes of Iran's citizenry is the fact that it has stood up to the United States. Had the Shah been wise enough to stand up to Washington, we might never have witnessed an Iranian Revolution. Furthermore, Iran's independence from the United States buys much support among disenfranchised Muslim masses in the Middle East.

Finally, let us again emphasize basic facts. Iran will not abandon its right to nuclear power development, including enrichment. If the United States wants to take away Iran's rights, then there is only a comprehensive military option. Bombing Iran will not achieve US goals, because Iran will become even more determined to master enrichment and to develop nuclear weapons. To have any control over Iran's actions, the United States would have to invade Iran and occupy Iran for many years into the foreseeable future. Here are three steps that could help everybody steer clear of an all-out war and that could guarantee the peaceful nature of Iran's nuclear program. First, engage Iran in a dialogue with no preconditions. Second, discuss all bilateral and regional issues with Iran and embrace policies to better integrate Iran into the world economy so that it has demonstrably more to lose by continued belligerence and isolation. Third, accept Iran's right to peaceful nuclear enrichment, with the understanding that Iran will agree to a number of safeguards (including the most intrusive inspections to date) to guarantee, as much as humanly possible, that it will not develop nuclear warheads. This contract could serve as a model to safeguard the future of nonproliferation and is the only peaceful approach to a resolution of the nuclear standoff with Iran.

Appendix 2: Iran Sanctions

For the longest time, conventional wisdom had been that economic sanctions on Iran were ineffective. Then, after (i) the UN adopted Resolution 1929 in June 2010, prohibiting Iran from buying heavy weapons, toughening financial transactions with Iranian banks, increasing travel bans, and supporting more cargo inspections, (ii) the United States announced measures to fine companies that sold gasoline to Iran and entities that engaged in financial transactions with specified Iranian entities, and (iii) the EU adopted tougher initiatives than the UN, officials expressed "surprise" that sanctions were beginning to squeeze the regime in Tehran.

Before 2008, sanctions on Iran were a porous hodgepodge. Iran could sell its oil and buy almost everything it needed from non-US sources, and could even acquire most US goods through third countries (principally the UAE) at a price that was only 5–10 percent higher than if those goods had been bought directly from the United States. Then in November 2008, the Treasury revoked the U-Turn License of Iranian banks. The revocation of this license meant that US banks could no longer make dollar transfers to Iranian financial institutions. Most importantly, this was followed in December 2009 by a record fine of $536 million on Credit Suisse for violating US sanctions on Iran; essentially, either Credit Suisse paid the fine or it would be barred from operating in the US market. This was followed in 2010 by a fine of $350 million on Lloyds Bank and $298 million on Barclays. These fines were the key to making sanctions bite because Iranian banks were virtually cut off from the international financial system. Iran's cost of trade skyrocketed, in our estimation by some 20–25 percent, in turn squeezing Iran's foreign currency reserves. The impact of these fines was then reinforced by UAE banks, which, under pressure from the US Treasury, ended their role as a conduit of funds to Iran. This further squeezed Iran's dwindling foreign exchange reserves and sparked a dramatic fall in the value of the rial, falling by over 15 percent in a matter of two days.

Is this new round of effective sanctions the primary cause of increasing hardship on ordinary Iranians? No. Iran's economic failures are in large part self-inflicted. The Iranian regime has failed its people. Iran's economic performance since the revolution in 1979 has been miserable. While its economic failure in the 1980s can in large part be attributed to the war with Iraq, performance during the period between 1990 and 2010 was the fault of the regime alone. Although sanctions have undoubtedly slowed the development of Iran's oil and gas reserves (since the adoption of the Iran Libya Sanctions Act, or ILSA, in 1996), the government has had ample resources, namely, easy money from oil, to achieve sustained and rapid economic growth. But instead of adopting sound policies to encourage private-sector growth, the government has squandered these resources to buy support through wasteful subsidies, enriching regime insiders, and pursuing military programs and grandiose foreign policy adventures, all of which it could ill afford. The citizenry has paid the price and will continue to do so as educated Iranians emigrate in record numbers for a better future elsewhere. Iran's economy was in a miserable state long before sanctions began to bite in 2010. To attribute Iran's economic failure largely to sanctions is simply incorrect.

Sanctions invariably fail to achieve their goal if the majority of citizens in the sanctioned country support the objectionable policy, in this case Iran's nuclear enrichment program. We believe that the majority of Iranians support this policy because of Iran's isolation during the Iran-Iraq War and the shameful use of Western-supplied chemical weapons on Iranians. Thus the US focus on Iran's nuclear policy has been a mistake from the start. But if the United States shifts its focus to the regime's human rights abuses, corruption, and failure to deliver economic prosperity, then success becomes more likely. This shift in US policy should be carefully considered because an agreement with an Iranian leadership that had the interests of its people at heart would be much more likely to be honored.

In view of the valid concerns for the welfare of the Iranian people, the essential question is this: will Iranians support enhanced sanctions that might increase their short-term economic deprivation if they might lead to positive change? The best that can be hoped for is for the citizenry to peacefully pressure the regime or to overthrow it, something that could cause hardship and even death. This is especially problematic in Iran because the regime has not hesitated to kill innocent demonstrators in order to hold onto power. On the one hand, if sanctions are enhanced, the regime could use what resources it has to supply the citizenry with the basic essentials of life in order to stay in

power. On the other hand, demonstrations in Iran confirm that the people of Iran are desperate for change. But is change more likely to come about with enhanced sanctions that motivate larger numbers of Iranians to openly oppose the regime?

Although sanctions have undoubtedly had a negative effect on Iran's economic landscape, Iran's economic failures are largely self-inflicted. Iran's less than stellar economic performance is well documented: real per capita income in 2007 was about what it was at the time of the revolution in 1979; income distribution is worse today; actual, as opposed to official, unemployment and inflation rates probably exceed 25 and 50 percent, respectively; there have been natural gas shortages for winter home heating and electricity for summer cooling; the social infrastructure to provide universal access to health care and higher education is inadequate; dire government budgetary pressures are necessitating a drastic cutback in consumer subsidies that have sustained the poor; and rapidly declining foreign exchange reserves threaten the stability of the Iranian currency and fuel the inflationary spiral. Iran's oil output is less than 50 percent of its pre-revolutionary level, and its natural gas development is pitiful when compared to its tiny, but gas-rich, neighbor Qatar. It is estimated that 150,000 educated Iranians are leaving every year to seek better opportunities elsewhere; and most important, average Iranians have lost all hope for a better future. All of this in a country that is a major exporter of oil, with the second largest reserves of natural gas and the third largest oil reserves in the world, and with combined oil and gas reserves equaling, or exceeding, Saudi Arabia's.

How did the regime fail its people so badly? The key economic fault lines in Iran today are government policies, corruption, and institutional limitations, not sanctions.

All Iranian institutions, especially the rule of law, are ineffective and are further corrupted by oil revenues. In countries that had strong institutions when oil was discovered, such as Norway and the United Kingdom, oil has been a blessing. But in countries that had weak institutions, such as Iran and Nigeria, the discovery of oil gave those in power the incentive to block institutional development to protect their personal interest. Thus oil may be as much a curse as a blessing.

Can removal of sanctions improve Iran's economic performance significantly? To our mind, the removal of sanctions under the realities of 2013 Iran will improve economic performance somewhat but not significantly and may in the end hurt the people of Iran and help the regime. Changes in sanction policies have a limited effect

on economic performance. Instead, it is the government of Iran that has the means to turn things around. The government is reluctant to adopt policies that may be problematic in the short run because they are unpopular with large and influential segments of the population. But the longer the government waits to embrace comprehensive reforms, the more difficult it becomes to implement needed changes. Although sanctions may have adversely affected foreign investment in Iran's energy sector, the major reason for the slow development of Iran's oil and gas reserves has been the perception of Iran as unstable. Iran's own policies deter foreign investors. Ironically, this slow development may in the longer run turn out to be beneficial to Iranians because revenues may be used more wisely in the future than they have been under this regime. Also, foreign direct investment (FDI) in Iran's non-oil sector has been pitifully low since the revolution. While this again may be in part due to sanctions, it is primarily due to Iran's unfavorable perception as a destination for FDI and Iran's dismal economic policies and performance.

To our mind, a forgotten beneficial effect of sanctions has been to limit Iran's access to external borrowing. Governments such as Iran's, caught in a bind, are apt to resort to external financing and use the proceeds to buy local support and to line the pockets of high officials, leaving future generations in the hole. The regime in Tehran has already gone through such a cycle. In Iran's revolutionary constitution, external borrowing was prohibited. But in 1988, in the aftermath of the Iran-Iraq War, the government engaged in massive borrowing of about $35 billion. Much of this money was wasted or pilfered. Iran has since paid this back. The lifting of sanctions could ignite another borrowing binge to the detriment of average Iranians, because the government is unlikely to use such funds productively.

Part II

The Political Economy of Oil and Transition to Oil-Less Economies

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Chapter 6

Oil—Islam, Ownership, and Institutions*

In this chapter, we ask what Islam has to say about the ownership and management of natural resources, especially those that are depletable such as oil and natural gas, and their beneficiaries. First some background.

Islam is a rules-based religion. Rules are spelled out and Muslims are required to be rule compliant. Islam's teachings on human and economic development are expounded in the Quran and were operationalized by the traditions of the Prophet Mohammad. The Quran provides the framework and specifies rules (institutions) that are, to a degree, abstract; the traditions of the Prophet articulate the operational form of these rules and provide the foundational structure of a society centered on the Oneness of God. During the 13 years the Prophet spent in Medina, he detailed and practiced all the following rules regarding: governance, accountability, and transparency; property ownership and protection; the formation and the structure of the market; the role of the state vis-à-vis the market; behavior by market participants; distribution and redistribution; education, technological progress, and society's infrastructure; and, finally, government income and expenditure. Most relevant for us here, the Quran and the traditions of the Prophet provide clear guidelines on ownership of natural resources and on how depletable resources should be managed in a Muslim society. In this chapter, we outline what Islam preaches about ownership, possession, and management of natural resources, in particular resources that are depletable, in our case oil and natural gas.

The central framework of all rules in Islam is justice. The Prophet preached the importance of justice and all of its ramifications for

human behavior. He particularly emphasized the equality of individuals before the law, and that all rules that are incumbent on individuals and their collectivity must be more strictly observed by those in positions of authority. "Authority may survive disbelief but not injustice." Insistence on justice in all facets of human existence on this earth became the hallmark of the institutional scaffolding of governance, a structure with full transparency and accountability.

During his life in Medina, the Prophet clarified rules of property rights over natural resources—land, water, the content of mines, all depletable resources under the ground, and all that Allah had given humankind. Humans, in their collectivity, are entrusted with the responsibility as "agent-trustees" of Allah to manage His gifted resources. As trustees, humans are expected to remove economic obstacles created on the path-to-perfection of individual humans, who otherwise face the scarcity of these resources.

The first and most important principle of property rights acknowledged the permanent, constant, and invariant ownership of all property by Allah. In Islam there is a difference between ownership and possession, and humankind does not have absolute ownership. Allah is the absolute Owner of everything. The second principle acknowledges the transfer by Allah of the right of possession to all humankind. Allah has made humankind the trustees of His creation on this earth. Humankind, not the state or a particular select group of humans, is entrusted with this trusteeship. Trusteeship entails ownership rights as well as responsibilities, with the understanding that the more fortunate must share with the less fortunate.

The third principle mandates equal opportunity of access by all to the natural resources provided by the Creator, to be combined with their labor to produce goods and services. The fourth rule recognizes only two ways in which individuals gain legitimate property rights: (1) through their creative labor, and/or (2) through transfers—exchange, contracts, grants, or inheritance—from others who have gained the property rights title to an asset through their own labor. Thus work is the basis of the acquisition of right to property. The fifth rule forbids gaining instantaneous property rights without working to earn them. The exception is lawful transfer. This rule also prohibits property rights gained through gambling, theft, earning interest on money lent, bribery, or, generally, from sources considered unlawful. Just as work is a right and an obligation of all humans, access to and use of natural-physical resources provided by the Creator for producing goods and services are also every human's right and obligation. All humans are ordained to apply their creative labor to these resources

to produce what society needs. If an individual, for whatever reason, lacks the ability to work, this does not deprive him of his original right to resources granted to every human by their Creator.

The rule of the "immutability of property rights" constitutes the sixth rule of property relations. This rule sanctifies the duty of sharing. Before any work is performed on natural-physical resources, all humans have an equal right and opportunity to access these resources. When individuals apply their creative labor to resources, they gain a right to priority in the possession, use, and exchange of the resulting product without nullifying the original property rights of the Creator or the rights He granted to all humans in the final product or the proceeds from its sale. The duty of sharing the product or the income and wealth proceeding from its sale constitutes the seventh rule of property relations, which relates to property ownership rights as a trust. This rule is operationalized through the ordained duties imposed on income and wealth, which must be paid to cleanse income and wealth from the rights of others. This is perhaps the reason why the Quran refers to these duties as "zakat," from the root word meaning cleansing and purification. In a society in which there is poverty amidst plenty, the roots of inequality must be traced to distortions in the pattern of resource endowments, in the workings of the exchange and/or distribution mechanisms and/or in the redistributive framework.

The eighth rule of property relations imposes limitations on the right of disposing of property—a right that is absolute in the Western concept of property rights. In Islam, individuals have an obligation not to waste, squander, or destroy, or to use property for opulence or unlawful purposes. Once the specified property obligations are appropriately discharged, including that of sharing in the prescribed amount and manner, property rights on the remaining part of income, wealth, and assets are held sacred and inviolate, and no one can force their appropriation or expropriation.

To ensure the property rights of all members of society, property rights over natural resources (such as mineral deposits, land, and water resources) were placed in trust of either the state, to be used for the benefit of all, or in the hands of society at large as commons (for example, surface water and underground water aquifers). A clear distinction was made between the right of ownership and the right of possession, particularly in the case of land. Any individual could combine labor, capital, and available land to produce a commodity over which the person would have full property rights. The land would remain in the person's possession as long as the land

was in production. However, if the land was not used for continuous production (for a designated period, for example, three consecutive years), the person would lose the right of possession, and another producer would have the right to take possession of the land to use labor and capital to produce a commodity. The right of ownership is most critical when it comes to the depletable natural resources (oil, gas, diamonds, gold, and the like) that God bestowed for the equitable benefit of all humans throughout all generations. If a limited number of humans or generations depleted these resources, then the rest of humankind would have been robbed. It is worth emphasizing that the Prophet underlined the rule that access to all natural resources is available to all members of society, and generations, regardless of their beliefs.

To protect the interests of society and maintain social order and stability, the Prophet enunciated rules, based on those already prescribed by the Quran, to give priority to the rights of society over those of the individual. The Prophet focused the attention of producers and consumers on the social costs and benefits of their action-decisions rather than on their private costs. This would induce greater efficiency in the use of resources to benefit society. The rule of "no harm, no injury" was promulgated by the Prophet based on the Quran to ensure that there is no adverse impact of private economic behavior on third parties or on society. The purpose of this rule appears to be to promote the convergence of the private and social costs of economic activity. In accordance with prescribed rules, the Prophet prohibited theft, bribery, interest on money, the usurpation of the property rights of others by force, and other ethically and morally forbidden activities as sources of income and wealth. These activities create instantaneous property rights without commensurate exertion of labor in production and are socially unproductive and harmful.

Recalling that justice is at the heart of an Islamic society, who then is ultimately responsible for establishing a just society? The state's role is that of administrator, supervisor, and protector of society. It is the members of society who ensure that justice prevails. In an Islamic society, the management of natural resources, especially those that are depletable, must be just and preserve the rights of all. Allah has provided humankind with sufficient resources if they are managed well and shared justly.

It follows in many verses from the Quran, and in total contrast to conventional economics, that scarcity in Islam is not a binding constraint at the level of humanity. It is only a constraint at a micro-individual level; at this level it is a test both for the person who is

constrained and for the person who is not constrained. For the constrained, it is a test of the strength of belief. For those economically better off, it is a test of their recognition of the real source of their wealth and the strength of their rule-compliance in helping remove economic constraints, namely, barriers from the path-to-perfection of those in need of help.

The linkage between oil and gas reserves and institutions, especially the rule of law, is at the heart of the question of whether oil reserves have a positive or negative effect on oil-rich countries. A glance at countries with significant reserves of oil reveals one undeniable fact. Countries that have benefited—achieved enhanced economic development and growth—from significant oil and gas reserves are countries that had good institutions and legal traditions before the discovery of oil and gas reserves. If countries have good institutions, including legal institutions and the rule of law, the discovery of reserves on public lands and offshore lead either to the competitive leasing of these rights for development by the private sector or development by the state; and no matter whether public or private development the proceeds are used to benefit all generations of citizens. That is, oil and gas reserves on public lands and offshore are leased and exploited in a way that maximizes the public benefit for all generations. In the absence of good institutions, much of the oil revenue is pilfered or leases are underpriced, robbing current and future generations of their birthright. Later, as oil comes on line, good institutions enable the state to collect royalties (if called for under lease arrangements) and to assess and collect taxes, while assessments are low and royalties and taxes go uncollected in the absence of effective institutions. Even with the availability of revenues from oil sales, lease payments, royalties, and taxes, the associated benefits depend on how productively the government uses the resources.

In most countries, especially developing countries, exhaustible resources are the property of the state and, in turn, the heritage of current and future generations. The state has the responsibility to preserve equal benefits for all generations. Economists have long recognized the special characteristics of exhaustible resources as a part of society's stock of capital, not to be used to finance consumption. Instead, commensurate capital of another form should replace the depletion of exhaustible resources for the benefit of current and future generations. In the case of Islamic communities, where much of the world's oil resides, this must be done in such a way that all citizens—current and future generations, rulers and the ruled alike—benefit equally as required by Islam; just as societies must take care of the air

and water for their own lives and for all who follow them, they must take care of their exhaustible resources for the benefit of all generations. Again, how effectively and efficiently this is done depends on the quality of institutions.

While it may appear from the above that the exploitation of oil reserves in countries that lack good institutions may afford little benefit, the fact is that oil may actually impact development and growth negatively, thus reducing development below that of comparable countries that do not have oil. This would confirm the notion of the "curse" of oil. Again, the reasons are intuitive and are supported by facts. The discovery of oil reserves in countries that are developing, that lack checks and balances and effective institutions, gives added incentive to those in power to solidify their position and to be repressive. Their goal is to capture as much as possible of the income from oil (or oil rent that represents the price of oil minus its production cost) for personal benefit (commonly referred to as rent-seeking activities). Given this goal, the last thing the ruling elite wants is to establish effective institutions. The rulers do not need a productive economy to generate output and revenues to finance their lavish lifestyle, because oil does this and more. As a result, what might be considered the foundational basis of development—effective institutions—is turned upside down, because effective institutions would reduce the ability of rulers to succeed in their pursuit of personal enrichment. Instead of nurturing effective institutions, the goal becomes the prevention of good institutions, with all the attendant negative fallouts.

Most, if not all, of the facets and the fallouts of the oil curse have been on display during the "Arab Spring" or "Arab Awakening" of early 2011 in the Middle East and North Africa. All of the countries with abundant oil reserves, all Arab with the exception of Iran, have been under harsh unrepresentative rule; the ruling elites have benefitted from the exploitation of oil reserves, with vast fortunes squirreled away abroad, while the majority of the citizens live under varied degrees of deprivation; economic performance has been below that of developing countries that did not have abundant oil reserves; military expenditures and arms imports as a percentage GDP have been high; and all of the countries have been plagued by corrupt and ineffective institutions (see chapter 8 for a brief assessment of the performance of Persian Gulf countries). The major demand of protestors in these countries could only be addressed with better institutions and representative governance, precisely what is recommended by Islamic teachings.

Developing oil-rich countries have suffered, and continue to suffer, from inadequate and ineffective institutions. Institutions are

essentially formal and informal rules, with enforcement characteristics. Once rules are in place, they allow coordination among individuals who share a belief in rules and their outcome. It is the ability of rules to reduce ambiguity about the behavior of others that allows coordination in human interaction and a subsequent emergence of collective action. More specifically, the institutional structure of a society is composed of constitutions, laws, and rules that govern the society, its government, finances, economy, and politics; written rules, codes, and agreements govern contractual relations and exchange and trade relationships; and commonly shared beliefs, social norms, and codes govern human behavior. The higher the degree of rule compliance, the more stable the social order and the lower the transaction costs in the society. In countries that have ineffective institutions when they discover oil, the prevention of adequate institutions and all that goes with it, as described above, becomes the all-important goal for those in power and those who hope to benefit from rent-seeking activities.

Economists know that ineffective institutional structures result in poor economic performance. The absence of good institutional structures usually reflects an entrenched belief system that cannot change because changes would pose a threat to existing political, religious, or business leaders. Needed changes in the institutional structure may be difficult to implement, because social norms are often inflexible and their enforcement characteristics are slow to respond to attempts for change. A major conclusion of economic research has been that without adequate institutional structure, policies to improve economic performance—such as creating an incentive structure for the private sector—would fail to lead to rapid and sustainable economic development and growth. Even a cursory glance across countries that are richly endowed with oil would confirm the sorry state of their institutional infrastructure. The oil-rich developing countries of the Persian Gulf exhibit the highest degree of corruption (as revealed by most available corruption indicators) and thus economic and financial uncertainty of any region in the world. As expected, this corruption extracts a heavy price by reducing economic and political growth and development. In the absence of political reform, dictators will beget other dictators who will adopt the corrupt policies of their predecessors.

The notion of equity and social justice is of paramount importance for countries with large oil and gas resources. Robert Solow has addressed this issue, most elegantly:[1] The finite pool of resources (I have excluded full recycling) should be used up optimally according to the general rules that govern the optimal use of reproducible

assets. In particular, earlier generations are entitled to draw down the pool (optimally, of course!) so long as they add (optimally, of course!) to the stock of reproducible capital.

What if governments cannot, or will not, optimally add to the stock of reproducible capital? The clear need is to find an alternative to Solow's prescribed optimal drawdown and optimal addition to reproducible capital. A viable option is to take all oil revenues away from the government and create a fund to address issues of equity. Additionally, this may be the only way in which the interests of future generations can be preserved. For instance, if governments were to use oil revenues to build roads and bridges, it is not at all evident that future generations of citizens would receive the same benefit as current generations. Moreover, as the government spends current oil revenues, some citizens will benefit more than others. For instance, those who own construction companies and build roads and bridges will benefit more than the rest of the populace. Possibly the only feasible way to preserve equity is to make the same (real purchasing power) direct cash transfers to all citizens, in this and future generations.

Again, if any proposition regarding the management of exhaustible resources is to be effective in Muslim countries, it must be compatible with basic Islamic teachings on the ownership and extraction of depletable resources.[2] Absolute ownership (by law) belongs to God. All members of society have an equal right to use and enjoy the advantages and benefits of communal property:

> Seek instead, by means of what God has granted thee, (the good of) the life to come, share in this world; and do good (unto others) as God has done good unto thee: and seek not to spread corruption on earth: for, verily, God does not love the spreaders of corruption. (Quran 28:77).

The matter of equality is further stressed in the context of Islamic economics, which is unique in its assertion that the distribution of resources is the main economic issue to be addressed by society; and that everything that is depletable belongs to society at large; that is, all citizens should have an equal share in the fruit of what is under the land; this incorporates both current and all future generations. Thus Solow's prescription is exactly what should be followed in these countries, with one important additional requirement. Solow's concern is intergenerational equity. In Islam, it is generational as well as intergenerational equity that matter.[3]

Upon reading this chapter and looking at the economic landscape of the Persian Gulf, especially how the benefits of oil and gas

resources have been managed and distributed, the reader must be in a state of disbelief. How could these countries diverge so much from the teachings of the religion they profess?

The management of oil resources has been and continues to be a major source of conflict in all the Persian Gulf countries. Muslims believe that they should receive an equitable share of oil resources. But they don't. The rulers take what they will. The general citizenry get the crumbs. It is not difficult to see the injustice and why oil is the source of resentment and conflict in the region. But that's not even half the story. As we will see in the next chapter, even some foreigners may benefit more than the general population. But not only do the citizenry benefit little from the depletion of oil, their governments have mismanaged their economies so that many cannot even get decent jobs to support their families. At the same time, future generations may get nothing from the depletion of oil because oil will run out and will have to be replaced by other sources of energy. Contrast the state of affairs in the Persian Gulf with the situation in Norway—a country with much more limited reserves than most of the Persian Gulf countries but with good institutions (the rule of law) in place when oil and gas resources were exploited—a developed country with a transparently managed (by the Norwegian central bank) and nationally owned global oil fund that had holdings of some $670 billion at the end of 2012.[4]

Summary

In Islam, there is an important distinction between ownership and possession. The first and most important principle of property rights in Islam is the permanent, constant, and invariant ownership of all property by Allah. Humankind does not have absolute ownership. Allah is the absolute Owner of everything, and He has transferred the possession of His creation to humans as trustees, with rules to guide them in the distribution and management of all that He has provided.

When it comes to depletion of natural resources, Islamic teachings are crystal clear. To ensure the property rights of all members of society, property rights over natural resources are placed in trust of the state or the community, to be used equitably for the benefit of all humankind in all generations, with justice as the underlying foundation. Rulers and other groups should not receive a disproportionate benefit. Institutions, rules, and rule enforcement must be the foundational elements of the just system envisaged in Islam.

Although Islam preaches justice and the equitable sharing of the benefits of natural resources between all humans and all generations, oil has upended all that. Although oil revenues have supported government revenues in countries of the Persian Gulf, economic and social injustice have become pervasive in all these countries. Oil has brought corruption. Current social, political, and economic interactions in these societies bear no resemblance to what is envisioned in Islam.[5] Islam preaches good institutions as the foundation and scaffolding of a just society, but rulers in the countries of the Persian Gulf thwart effective institutions so as to continue their corrupt and oppressive rule.

Chapter 7

Oil—Foreign Interference

Although foreigners discovered oil in the Persian Gulf and were instrumental in its production and export, they have not always been helpful toward the region's human, economic, and political development. They have on balance played a selfish role in the region; first by financially exploiting oil-exporting countries during the early years after discovering their oil and then by supporting autocratic and unaccountable dictators in the region, support that has invariably been tied to continued rewards from the exploitation of oil and gas resources in the region. Today, foreigners, principally the United States, the United Kingdom, and France, claim that they support political, social, and economic reforms as they prop up their favorite dictators and claim that their backing is intended for stability and the free flow of oil at a reasonable price for the world. But foreigners, be they countries, corporations, or individuals, have acted in support of their own perceived interests, with little or no regard for the fallout for the people and countries in the region.

In this chapter, we ask: (i) How have foreigners obstructed positive economic, social, and political change? (ii) What has motivated foreigners to support oppressive rulers while they profess their support for democratic governance and independent institutions? (iii) What has been the broad (details taken up in chapter 8) fallout from foreign interference?

The Role of Foreign Interference

Before roughly 1960, as we saw in chapter 2, foreigners, principally Great Britain, used force and the threat of force to control the Persian Gulf countries in their effort to exploit their oil resources largely for their own benefit, with meager rewards for the countries themselves. In the early years, foreigners exercised absolute control over Persian Gulf

oil. They received concessions over large areas of terrain; they determined the precise location of their concessions; they decided how much oil they would produce at each location; they decided how much they would export and to where; they determined the price of oil; and possibly most importantly, from the Persian Gulf countries' perspective, they decided the amount of revenue (be it in the form of royalties, taxes, or side payments) paid to each country. If and when a country threatened the company's interest, the company's home country used force or the threat of force to secure its interests. Although Persian Gulf rulers tried to protect their country's interests, it was an exercise in futility. They, and their families and cronies, could at least secure some personal benefits if they did not cause too many problems. In the end, authorities in the Persian Gulf countries did not know any working details, because even though they were major shareholders they did not have access to the operating companies' books (profit and loss statements and balance sheets). The operating companies, with their home country's support, ruled over the oil in the Persian Gulf. Great Britain was the dominant foreign power in the region, the hegemon of the Persian Gulf, with its corporate interests controlling most of the region's oil deposits. This was the pattern from the day oil was discovered up to the end of World War II. It was for all intents and purposes the rule of a traditional colonial, or as some may say imperial, power. In this setting, the people of the Persian Gulf saw foreigners largely as villains. Although they considered their rulers to be corrupt and submissive, their rulers were only carrying out the wishes of the foreigners who had power over them. It was the foreigners who controlled everything and robbed the people of their birthright. This was colonialism pure and simple, with popular anger largely directed toward the colonialists.

As World War II ended, American companies started to come to the Persian Gulf, at first slowly to Kuwait and then, more prominently, to Saudi Arabia, the country that would turn out to be the biggest oil producer of them all. Although the foreign companies colluded, the fact that there were more of them competing for concessions strengthened the bargaining power of the Persian Gulf countries. To the dismay of the British, the American companies seemed more "considerate" in their dealings with the oil producers. The first high-profile test of the changed post-World War II landscape in the Persian Gulf came in 1953, with Mossadeq's nationalization of Iranian oil. This was not a pretty picture. But it seemed that little had changed. Great Britain, with US collaboration, intervened in Iran, upended the will of the Iranian people, and restored as absolute ruler a beholden Shah along with British corporate interests over Iranian oil.

The 1953 coup and the return of the Shah, in our opinion, were in retrospect an important turning point in the role of foreigners in the region. In the early years and in the period after World War II, the companies colluded and dictated the terms of their oil exploitation, with the support of their home governments. Their hand in dictating the terms (something that could not be categorized as negotiations) was supported and backed by the overwhelming military force of their home countries and by a number of market factors that included their control over global oil sales and distribution (as the buyers of oil the companies controlled the market), their oil interests in a number of countries (they could reduce oil output in one country and increase it in another), and a global oil market where there was significant excess capacity (reducing the market power of producing countries). Over time, conditions changed.

As we discussed in chapter 3, the global oil market changed dramatically in the period from World War II to 1970—the global demand for oil literally exploded, the Persian Gulf and the broader Middle East's share of world oil output and exports climbed significantly, and smaller oil companies ventured abroad. Although changed market conditions and the formation of OPEC (1960) afforded the producing countries a better hand in negotiating with the companies, the companies saw their fortunes decline. The experience with Mossadeq's overthrow and the restoration of the Shah as absolute ruler, however, closed some windows but opened new doors—opportunities for the companies to regain some of their lost market power and influence over the producing countries. They realized that a "collaborative" relationship with the rulers would serve them better in the future by enhancing their access to Persian Gulf oil. Foreigners had restored the Shah to his throne and he owed them his throne. If rulers were propped up by foreign powers, they could be manipulated and would have little choice but to do the foreigner's bidding. Foreigners would get what they want and rulers would get what they want. This was the proverbial win-win situation.

Here was a break with the past in at least one important way. Before, foreigners and rulers were largely adversaries, but now with the passage of time they started to work hand-in-hand, something that has accelerated since the 1990s, especially with the GCC countries. Foreign governments, their oil companies, institutions, and powerful individuals have collaborated with unelected rulers to keep them in office to reap financial rewards, and they have in turn been rewarded by oppressive rulers for their backing. Colonialism has morphed from confrontation into collaboration, or collaborative colonialism,

between foreigners and rulers. Illegitimate rulers have come to thoroughly embrace the new arrangement at the expense of their people. Foreigners sanctimoniously profess support for political reforms and human rights while they wholeheartedly support oppressive, illegitimate rulers who subjugate their citizens and impede reforms. Dictators are so much easier to work with than elected governments.

As Great Britain's influence began to wane in the Persian Gulf in the 1960s and especially in the early 1970s, America's power began to rise. The US Secretary of State Henry Kissinger embraced the Shah of Iran as America's policeman in the region and sold him sophisticated arms, including the top-of-the-line Tomcat (F-14) fighter jets. America was still preoccupied with the Cold War and needed a surrogate in the region. After the Shah's downfall, Saddam Hussein briefly assumed the surrogate mantle, a mantle that was removed after his invasion of Kuwait in 1990. Then, after the breakup of the Soviet Union, the United States jumped with both feet into the Persian Gulf, establishing bases and deploying troops throughout the region to contain Iran and Iraq and to protect the oil-rich countries of the GCC.

How have foreigners supported rulers in these countries? Foreigners, principally the United States, have given these rulers support on a number of fronts: political, intelligence, military, and the promise of a safe haven for personal and financial safety. The United States is quick to use its unparalleled access to the global media to criticize the objectionable policies of an adversary but not of an ally; witness the muted criticism of Bahrain's rulers and of Saudi Arabia's support of and intervention in what must surely be considered crimes against humanity in the treatment of protestors in 2011 and 2012; witness Qatar, the supposed liberal country in the GCC, imposing a life sentence on a Qatari poet Mohammed ibn al-Dheeb al-Ajami for insulting the emir; and witness the shooting of Shia protestors in the eastern province of Saudi Arabia and a string of other harsh treatments of those protesting the repressive monarchies of the GCC.

The United States supplies life-saving intelligence to favored dictators and offers them support when they are in danger both from within their countries and from the outside. This support comes in the form of the threat of military intervention, which is lent ominous credibility by the pre-positioning of vital military hardware, the stationing of troops throughout the region, the display of a mighty military force, and the positioning of military advisors in every country that it supports in the Persian Gulf. The United States has flaunted international rules of engagement by supplying internationally outlawed weapons to its dictators (Saddam Hussein during the Iran-Iraq War) while

admonishing their use by others, such as Assad in Syria. When regimes collapse in spite of such support, the United States arranges a safe haven for toppled dictators and their corrupt booty. The price paid for corruption and crimes against humanity is kept low, below its real fallout price. The United States does all this and more to defend the rule of illegitimate dictators at the expense of the region's people, with ominous consequences for the future. It is no wonder why the people increasingly see their hopeless condition as the result of collaboration between their illegitimate rulers and intruding foreign powers.

The Foreigners' Benefits

The United States and other foreign governments support these dictators because of their own perceived short-term gains. In addition to preferential access to oil, foreigners—governments, corporations, institutions, and individuals—have received a number of direct benefits from the region's unelected rulers at the expense of the region and its people.

The data we have to support this claim is somewhat limited; we indicate the important channels of benefits afforded to foreigners, including some data and what others have said about Persian Gulf attempts to influence US policies.

(i) The US Congress and executive branch are highly susceptible to lobbyists. There are a large and growing number of officially registered lobbyists representing Persian Gulf interests. These lobbyists include some of the most prominent US law firms, public relations firms, and extremely influential ex-government officials in the United States. It may be useful to represent two figures here. Before commenting on these figures, we should note that these numbers largely exclude Iran and Iraq, given the severed US relations with these countries for most of the period in question. Thus they are essentially limited to the six countries of the GCC, with an aggregate native population of less than 25 million. Moreover, this represents only registered lobbyists. More prominent former US government officials and nongovernment officials may have significant contracts with these countries, but may not have registered, something that is assuredly so as they claim they are consultants and not lobbyists or simple beneficiaries of gifts. In Figure 7.1, we display the total number of registered lobbyists representing the interests of six Middle East Persian Gulf countries in the United States. Before the 1971 Tehran Agreement, the numbers were modest but have grown rapidly, though with

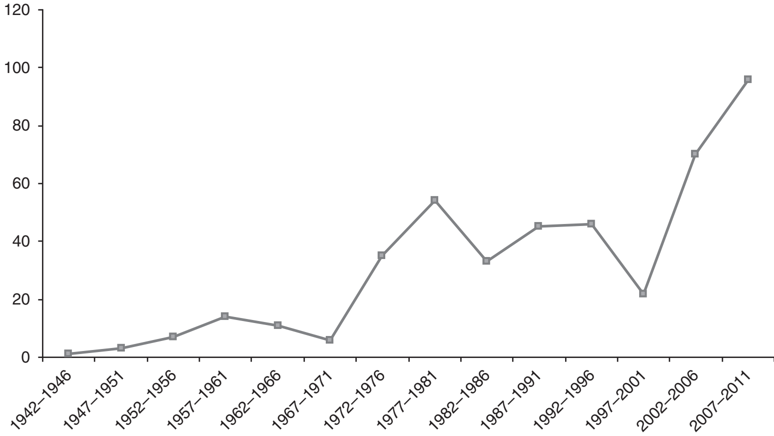

Figure 7.1 Number of registered foreign agents in the United States representing Persian Gulf oil exporters' interests

Source: Data from www.fara.gov.

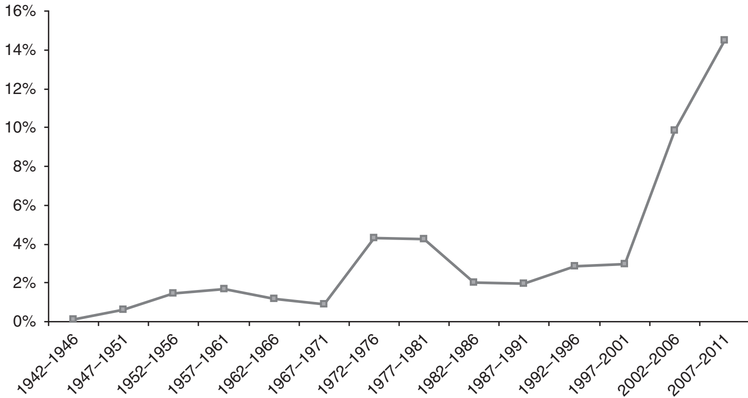

Figure 7.2 Registered foreign agents in the United States representing Persian Gulf interests as a percentage of the total number of registered foreign agents excluding Persian Gulf oil exporters' interests

Source: Data from www.fara.gov.

fluctuation, since then. In Figure 7.2, we show the representation of these countries relative to all registered lobbyists in the United States. The fact that six smallish countries represent nearly 15 percent of all US-registered lobbyists representing foreign interests should spark some interest. The reason is evident. These are rulers

of oil-rich countries who need US support to hold onto power and who are willing to pay for support.

(ii) Saudi Arabia has made grants since 1962, with the creation of the Muslim World League, which was created as an NGO to build mosques throughout the United States; in the 1980s, $10 million was spent on this effort.[1] As Mitchell Bard writes, the Saudis have directly invested in "the establishment of at least sixteen Islamic and cultural centers in California, Missouri, Michigan, Illinois, New Jersey, New York, Ohio, Virginia, and Maryland. At its peak, in addition to the diplomats engaged in political activity, the Islamic affairs department at the Saudi embassy in Washington had thirty-five to forty diplomats and an annual budget of $8 million."[2] Another purpose of investment by Arab nations, especially Saudi Arabia, as described by authors like Bard, has been in propaganda. In 1976, a wide network of influential analysts, consultants, and lobbyists in Washington were hired to allocate $15 million annually on propaganda. According to the plan, prepared by Martin Ryan Haley and Associates, the money would be spent on the campaigns of six senators in the 1974 election.[3] Bard identifies specific firms that have received Saudi money[4] and states that their role is to "facilitate meetings between the Saudis and members of Congress, congressional staff, and officials in the executive branch and have lobbied to support bilateral US-Saudi relations, Saudi cooperation on the global war on terrorism, oil and energy-related issues, economic development and the Saudi role in the World Trade Organization, Saudi reform efforts, the role of women, the Arab Peace Plan, and terrorism funding."[5]

(iii) In the period since 1986, the period for which we have data, the six oil-exporting countries of the GCC in the Persian Gulf have given gifts and grants to a number of US nonprofit institutions. Unfortunately, this information is not reported for all nonprofit institutions, only for US universities. In Figure 7.3 we present the gifts and grants from the six countries of the GCC. The size of these gifts and grants has accelerated and amounted to more than $500 million in the five-year period between 2006 and 2010. Most likely, these gifts and grants were awarded with one goal in mind, namely, to increase support from the United States for those in power (see Figure 7.4). In the case of Saudi Arabia, Bard cites gifts of $130 million between 1986 and 2007, with the gift of $18 million to the University of Arkansas (Islamic Studies) undoubtedly motivated by the Presidency of Bill Clinton. Other Saudi gifts include $29 million to the University of Virginia,

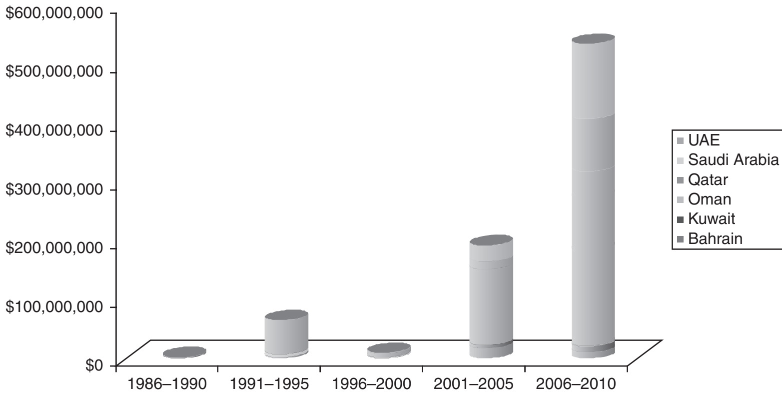

Figure 7.3 Gifts and grants to US universities from Persian Gulf oil exporters in 1986–2010

Source: Data from US Department of Education.

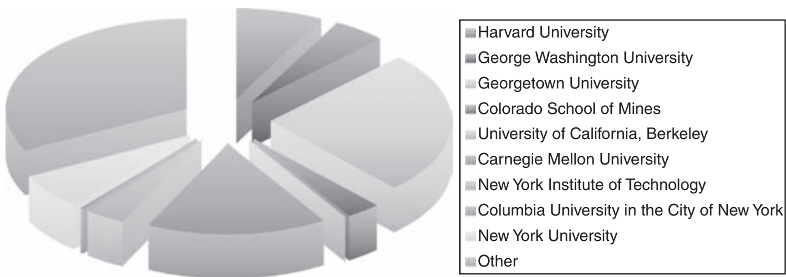

Figure 7.4 Share of funds received by major US universities from Persian Gulf oil exporters in 1986–2010 (total: $841 million).

$18 million to the University of Arkansas, $1.5 million to Texas A&M, $11 million to Cornell, $5 million to Rutgers, $1 million to Princeton, $5 million to Harvard Law School, $5 million to MIT, $5 million to UCLA, and $ 1 million to USC. [6]

(iv) In addition to gifts to US universities, the GCC has given significant gifts to organizations that are closely identified with former US presidents (presidential foundations and libraries). This data is even less complete and reported in ways that are painstaking to summarize. The Clinton, Carter, and Reagan websites report the names of donors but no gift amounts. The Clinton site reports the names and sizes of gifts within broad ranges. In the range

exceeding $25 million, there were four donors in 2011, all from domestic US sources; in the $10–25 million range, there were 13 donors, including two governments (the Kingdom of Saudi Arabia and the government of Norway); in the $5–10 million range, there were six donors, with the government of Kuwait as the only government entity; and in the $1–5 million range, there were 73 donors, including eight GCC-related donors, three of which were the governments of Oman, Qatar, and Abu Dhabi. The Bush and Ford sites report no names. Again, the donations of six smallish countries stand out. What is the goal of these countries in making these donations? Again, we venture to say, it is to secure political support at the highest levels in the United States. Moreover, we can say that there are GCC "contracts" with a number of former senior US officials. But such "consulting contracts" do not have to be reported and we are not at liberty to provide names.

(v) The imports of the Persian Gulf countries from the United States is significant, again primarily to the GCC because Iran has been sanctioned since 1979 and Iraq was sanctioned until recently. The ratio of imports from the United States relative to total imports is much higher for the Persian Gulf countries than for other comparable countries (Table 7.1).

Table 7.1 Imports of goods and services from the United States/total imports

Country	1975 %	1980 %	1985 %	1990 %	1995 %	2000 %	2005 %	2010 %
Bahrain	7.7	7.6	7.4	7.1	8.1	12.6	6.3	11.9
Iran	19.8	0.0	0.0	0.3	3.9	0.7	0.2	0.3
Iraq	8.8	—	4.4	10.8	0.0	0.4	11.8	6.4
Kuwait	18.0	14.5	8.4	10.9	16.1	12.1	14.3	13.4
Oman	9.6	5.7	5.7	9.2	6.5	5.4	6.2	5.6
Qatar	12.5	11.3	6.5	9.5	10.6	10.3	11.6	15.4
Saudi Arabia	17.1	20.0	17.0	16.7	21.4	19.0	14.8	12.3
UAE	15.1	13.5	11.0	9.1	8.4	7.9	8.6	7.4
Morocco	7.7	6.5	6.1	5.5	5.9	5.6	3.4	7.1
Tunisia	6.7	5.9	5.7	4.9	4.9	4.6	2.5	2.7
Pakistan	12.6	14.1	14.0	12.8	9.3	6.1	6.0	4.8
Bangladesh	25.9	13.8	10.2	5.1	6.1	2.4	2.4	1.9
Thailand	14.8	14.4	11.3	10.8	10.6	11.8	7.4	5.9

Source: International Monetary Fund.

Table 7.2 Arms imports of Persian Gulf countries from the United States

Country	Measure	1971–1975	1976–1980	1981–1985	1986–1990	1991–1995	1996–2000	2001–2005	2006–2010
Bahrain	Arms Imports from USA ($ billion)	0.001	0	0.071	0.61	0.163	0.564	0.129	0.099
	Arms imports from USA/total USA arms exports (%)	0.0	0.0	0.1	1.1	0.3	0.9	0.4	0.3
	Arms imports from USA/total arms imports (%)	12.5	0.0	23.4	67.3	86.2	97.9	76.8	50.8
Iran	Arms imports from USA ($ billion)	9.556	11.278	0.019	0.097	0	0	0	0
	Arms imports from USA/total USA arms exports (%)	15.4	16.7	0.0	0.2	0.0	0.0	0.0	0.0
	Arms imports from USA/total arms imports (%)	72.8	75.3	0.7	3.2	0.0	0.0	0.0	0.0
Iraq	Arms imports from USA ($ billion)	0	0	0.036	0.164	0	0	0.052	1.145
	Arms imports from USA/total USA arms exports (%)	0.0	0.0	0.1	0.3	0.0	0.0	0.2	3.1
	Arms imports from USA/total arms imports (%)	0.0	0.0	0.2	1.4	—	—	19.9	63.2
Kuwait	Arms imports from USA ($ billion)	0.064	0.766	0.253	0.075	1.997	1.366	0.031	0.302
	Arms imports from USA/total USA arms exports (%)	0.1	1.1	0.4	0.1	3.1	2.3	0.1	0.8
	Arms imports from USA/total arms imports (%)	28.8	50.5	16.4	10.4	72.5	61.9	20.3	80.1

Oman	Arms imports from USA ($ billion)	0.035	0	0.149	0.063	0.042	0.044	0.163	0.339
	Arms imports from USA/total USA arms exports (%)	0.1	0.0	0.2	0.1	0.1	0.1	0.5	0.9
	Arms imports from USA/total arms imports (%)	9.0	0.0	18.2	23.7	8.4	7.3	52.4	70.6
Qatar	Arms imports from USA ($ billion)	0	0	0	0	0	0.001	0	0.28
	Arms imports from USA/total USA arms exports (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.8
	Arms imports from USA/total arms imports (%)	0.0	0.0	0.0	0.0	0.0	0.1	0.0	90.0
Saudi Arabia	Arms imports from USA ($ billion)	0.941	3.244	5.807	3.928	5.143	6.3	0.714	1.125
	Arms imports from USA/total USA arms exports (%)	1.5	4.8	9.0	6.8	8.1	10.4	2.4	3.1
	Arms imports from USA/total arms imports (%)	86.2	71.5	71.8	42.5	78.6	73.7	33.3	43.2
UAE	Arms imports from USA ($ billion)	0.069	0.013	0.196	0.366	0.335	0.211	1.743	2.715
	Arms imports from USA/total USA Arms exports (%)	0.1	0.0	0.3	0.6	0.5	0.3	5.8	7.4
	Arms imports from USA/total arms imports (%)	17.6	1.3	16.3	22.3	16.8	8.1	38.2	55.2

(vi) The Persian Gulf countries purchase a significant quantity of arms from the United States (Table 7.2). Iran used to rely on US arms under the Shah but has not done so since the Iranian Revolution (1979), and Iraq is in a state of transition. In the period between 1971 and 1975, Iran and the six countries that make up the GCC today bought 17.2 percent of all US arms exports; between 1976 and 1980, they bought 22.6 percent; after the Iranian Revolution, from 1981 to 1985, the six GCC countries alone bought 10 percent of all US arms exports; from 1996 to 2000, the GCC alone bought 14 percent of all US arms exports; and in the most recent period, between 2006 and 2010, the GCC and Iraq bought 16.4 percent of all US arms exports. These figures represent a significant percentage of US arms exports and they exclude significant service contracts with US arms manufacturers. This in spite of the fact that a number of these countries cannot maintain, and in some cases cannot man, some of the equipment they buy from the United States. The countries of the Persian Gulf have the highest ratio of arms imports per capita of any region in the world, and the arms are largely imported from the United States, followed by the United Kingdom and France.[7] If countries cannot maintain and use these arms to defend themselves, the three most reasonable explanations for such vast imports of arms (and service contracts on which we have no data) are for pre-positioning (to be used by US forces), for reducing the unit cost of US arms (in support of US military expenditures), and for rewarding US military contractors.

(vii) Foreigners who support rulers in the Persian Gulf derive another potential benefit through the purchase of US financial securities by the rulers they support. The available debt data from the US Treasury does not include short-term US bonds, the preferred investment vehicle of Middle Eastern central banks, and thus the data is not supportive of our representation (a little over 4 percent of US government debt held by the Middle East oil exporters); and for all US security holdings, the oil exporters represent only 3.3 percent. In the aftermath of the Arab Oil Embargo of 1973–1974, the US Secretary of the Treasury, William Simon, initiated a program that allowed the SAMA to bypass regular auctions and directly acquire US government bonds. Moreover, at that time, the US Treasury and the Saudi Ministry of Finance signed an agreement whereby the Ministry of Finance of Saudi Arabia would pay for American technical assistance. Moreover, "a Joint Economic commission

(JECOR) was also formed to facilitate contracts and to create a vehicle for justifying US technical assistance and feasibility studies. It was established by executive order and paid for by the Saudis, which allowed the Nixon administration to side step Congress."[8] Wealthy citizens of the GCC and Sovereign Wealth Funds (SWF) from the GCC have at times stepped in to support various US financial institutions, such as Citibank.

(viii) In addition to the purchase of US financial securities, the outflow of funds from the Persian Gulf to offshore wealth havens has been significant. In our view this capital flight is an attempt to hide vast wealth, in many cases wealth that may be ill gotten. In 2011, of the little over $4 trillion of the stock of foreign wealth that was deposited or managed in Switzerland, Britain, the Channel Islands, and Ireland, about $1.1 trillion, or about 25 percent, originated from the Middle East and Africa.[9] We do not have data for outflows from the Persian Gulf, but only aggregated numbers for such flows of funds from the entire Middle East and Africa; these available numbers, in our view, may be made up substantially by those from the Persian Gulf because the flow of funds from the Middle East excluding the Persian Gulf and from Africa are likely to be quite small.

(ix) Another important area of benefit to foreigners is in the realm of service contracts (engineering, military, consulting services, etc.) awarded to US firms and individuals. We have, however, been unable to find any consistent data on these. However, it is easy to note that the mega engineering contracts of the GCC have been largely awarded to US firms.

To reap these economic and financial benefits, foreign powers have supported unelected and oppressive rulers to hold onto power, a policy that has been justified in the name of stability and the free flow of oil at a reasonable price.

The Foreigners' Fallout

Oil has afforded the means to Middle Eastern rulers to buy the support of foreign governments. Without oil, this would not have been possible. What interest, if any, would have attracted foreigners? The foreign involvement in the Persian Gulf, in turn, has had many fallouts. Here we mention the broad outlines of the most important fallouts and address the more detailed (with numbers and indicators) economic, social, and political outcomes in the next chapter.

Foreign support has, first and foremost, given unelected rulers the wrong motivation for governance. Rulers have had no incentive to adopt and nurture effective institutions, as these, such as the rule of law, would only undermine their rule. Instead of adopting good governance to maintain their rule, they and their cronies have plundered their countries and relied on foreign support to stay in power. In other words, foreign support may have been instrumental in impeding long-term reforms. Moreover, there is no wall between the national treasury and the personal accounts of those in power in the Persian Gulf countries. For the Saudi kings and princes to be as incredibly wealthy as they are, they are either the most astute businessmen or they are horribly corrupt. The emir and his family in Qatar are either great investors or they are plundering their country's wealth. The support of foreigners has indeed allowed these countries to defer turmoil, instability, and conflict, but the present course will lead to more costly clashes in the future, with unimaginable human tragedy and economic deprivation. Political repression, economic failure, and social injustice will fuel regional conflicts—interstate as well as intrastate. Conflicts (ethnic, sectarian, tribal, social, etc.) will only grow with time unless reforms and reconciliation are adopted soon. If the more populated nations—Iran, Iraq, and Saudi Arabia—fail politically and economically, the smaller countries—Kuwait, Qatar, and the UAE (really Abu Dhabi)—may face regional aggression that will threaten their very existence.

Summary

Although the persistence of autocratic rule is the overarching outcome, the fallouts for citizens are many: absence of political, economic, and social reforms; subpar economic performance—in terms of economic growth, employment, and economic diversification; objectionable and unjust income distribution and poverty; and pervasive injustice in most spheres of life. Rulers have no incentive to establish efficient institutions that are the foundation of political, economic, and social development. As a result, we see widespread dissent and hopelessness in the region.

Prior to the 1950s, popular resentment in the Persian Gulf was mainly directed toward foreigners, but recently resentment has become increasingly directed toward oppressive rulers and their cronies. Radicals and terrorists target the foreign supporters of tyrants. We have seen some of these grievances played out throughout the Arab World in recent years, especially between 2011 and 2013. While

the conservative monarchies of the Persian Gulf have, more or less, managed to keep the lid on dissent (with the exception of Saudi Arabia and especially Bahrain), the question is how long will they be able to do so?

What would have happened in the absence of foreign interference and support for oppressive rulers? We can only guess. Yes, there would have been more instability in most, if not all, of the countries, but we believe that better institutions would have gradually developed over time. We believe there would be more freedom, more elected and accountable governments, and more progress toward developing civil societies. There would have been fewer interstate wars and much less destruction. But what is truly frightening is not the past, but the future.

The future is ominous. Oil revenues will decline and current economic policies will become unsustainable. A turnaround will absolutely require the unselfish participation of the United States and of other foreign powers. Although the United States has already paid a heavy price in blood and treasure in the Persian Gulf, this could be eclipsed by far worse in the future. The time is now for the United States to stop thinking about short-run benefits and take a good look at the long-run catastrophes that could unfold. The region is in desperate need of fundamental reforms, reforms that will need foresight and sacrifice by rulers and by foreign powers. This will be possible only if foreigners, principally the United States, begin by acknowledging a simple fact—the rulers that they support in the Persian Gulf are oppressive, corrupt, and have no incentive to change. It is time to support leaders who are willing to embark on the path of democratic reforms based on social and economic justice.

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Chapter 8

Oil—The Fallout in the Persian Gulf

The eight countries of the Persian Gulf—Iran, Iraq, and the six that constitute the GCC—have received vast oil and gas revenues over the last 40–50 years. Between 1975 and 2011, the high quality of their oil and gas deposits, which translates into a low average cost of production and thus enormous rents from oil extraction (that is the difference between the price of oil and its production cost), has afforded them average resource rents as a percentage of GDP that are simply staggering in comparison to the world average: Bahrain (33.8 percent), Iran (28.9 percent), Iraq (61.8 percent), Kuwait (49.9 percent), Oman (44.8 percent), Qatar (45.8 percent), Saudi Arabia (45.6 percent), the UAE (26.2 percent), and the world (3.6 percent).[1] How have they fared—in growing and diversifying their economies, transforming their oil capital into other capital forms for future generations, enhancing human development, and establishing political and economic institutions to sustain development and growth? In this chapter, we basically report some performance data to assess the economic, human, social, and political achievements of these countries to date, and in the next chapter we will detail the difficult transition process from where they find themselves today to an oil-less economy.

In Figure 8.1, we see the average annual GDP and GDP per capita growth rates for the period between 1975 and 2011 (and for population growth rates Table 8.1). The results have been less than stellar. In fact these per capita growth rates are superior only to those of Sub-Saharan Africa. Only Oman, not a truly major oil exporter, has done better than the world average in terms of per capita GDP growth; Iraq's performance is not comparable since it is for a shorter period and, more importantly, the starting time for measuring GDP per capita growth

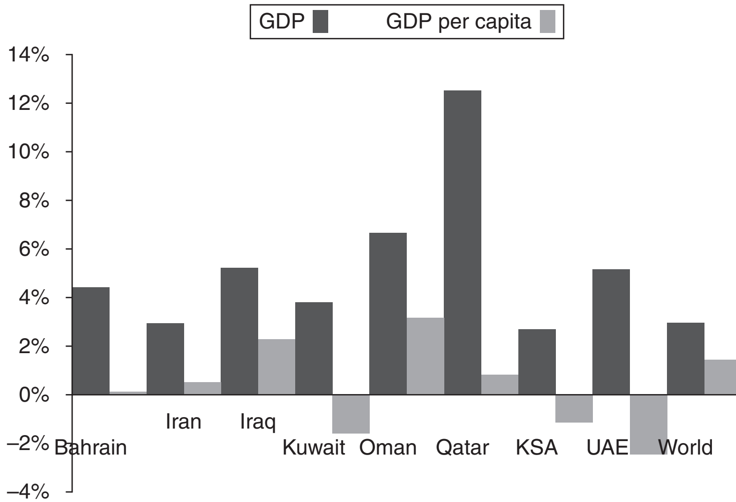

Figure 8.1 Average annual GDP and GDP per capita growth rates (%), 1975–2011
Note: For Bahrain (1980–2011), Iraq (1995–2011), and Qatar (2000–2011).
Source: Data from the World Bank.

Table 8.1 Average annual population growth rates

Country	1975–1980	1980–1985	1985–1990	1990–1995	1995–2000	2000–2005	2005–2011	1975–2011
Bahrain	6.15	3.43	3.32	2.64	2.78	1.39	10.51	4.49
Iran	3.22	3.62	3.23	1.72	1.74	1.39	1.19	2.27
Iraq	3.19	2.74	2.94	2.85	3.02	2.67	2.95	2.91
Kuwait	5.54	4.75	4.55	–1.28	3.29	3.29	3.72	3.86
Oman	5.31	5.47	4.04	3.89	0.69	1.03	2.62	3.27
Qatar	5.79	10.19	6.14	1.47	2.81	4.54	15.00	6.80
Saudi Arabia	5.60	6.16	4.36	2.99	1.55	3.41	2.79	3.81
UAE	14.31	6.43	5.80	5.35	5.21	4.66	11.99	7.80
World	1.80	1.77	1.77	1.58	1.41	1.25	1.18	1.53

Source: The World Bank.

was at the point after Iraq's economy was totally devastated by two wars (1995), with a level of per capita income that was a throwback to decades earlier. A number of the countries, especially those with small native populations and high per capita oil revenues, have performed well in

GDP (as opposed to GDP per capita) growth rates, but this has been in part because of a dramatic inflow of expatriate labor that in our opinion makes up over 85 percent of the population in Qatar, over 75 percent of the population in the UAE, and over 65 percent in Kuwait, with an even higher percentage of the labor force in these countries.[2]

While their broad economic performance has been subpar, these countries have also failed to diversify their economic base away from oil. But oil will be depleted at some point in the future and they will have nothing else to produce and export. After receiving significant oil revenues for over 40 years to help them diversify and grow their economies, they have largely failed. The share of fuel exports to total exports was still overwhelming during the period from 2005 to 2011: Bahrain (62.9 percent), Iran (78.7 percent), Iraq (85.6 percent), Kuwait (95.6 percent), Oman (86.5 percent), Qatar (86.6 percent), Saudi Arabia (89.7 percent), and the UAE (54.1 percent); with the UAE's apparent higher level of nonfuel exports due to Dubai's high level of reexports largely to Iran.[3] As a result of insignificant non-oil GDP growth, unemployment rates are high in the big countries of the Persian Gulf, despite the fact that public-sector employment is used as a safety valve; we estimate unemployment at over 20 percent for Iran and over 40 percent for Iraq; the available official estimate for Saudi Arabia is an understated 10.5 percent, with a labor force participation rate of only 36 percent.[4] For the smaller and richer (in oil and gas per capita) countries, unemployment of citizens is unlikely to be a major problem because they are absorbed into the public sector with high-paying jobs even if there is nothing for them to do, and all citizens receive significant subsidies for their day-to-day living. But even for these very rich countries, this sort of approach may not be sustainable, requiring at the least a formal savings and investment policy from current oil revenues to sustain future government expenditures and support for future generations (see chapter 9).

As we have said before, economies that rely heavily on a depleting natural resource, such as oil and natural gas deposits, should regard these deposits as capital to be replaced by other forms of capital that is not consumed but rather saved to afford returns to all generations. If oil and natural gas deposits finance consumption, then current economic activity cannot be sustained once oil is depleted and, as important, future generations will be robbed of their birthright as citizens. The indicated policy is to save a large fraction of current revenues and invest it for the equitable benefit of future generations (further addressed in chapter 9). Two indicators that would support this compensation for oil depletion are current account and budget

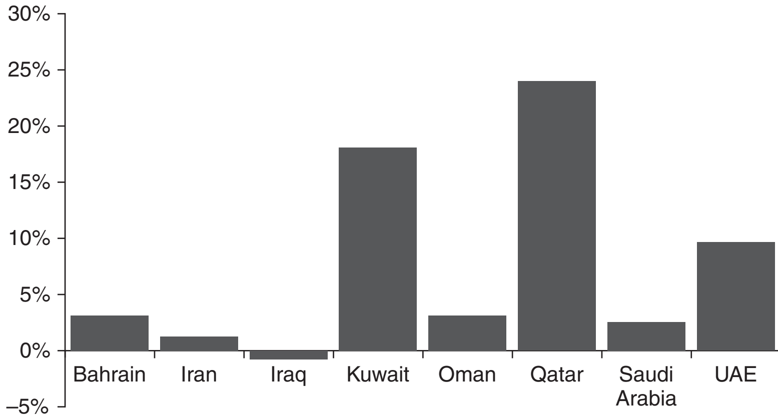

Figure 8.2 Average current account balance as a percentage of GDP, 1975–2011
Source: International Monetary Fund.

surpluses. As can be seen from Figure 8.2, only Qatar, Kuwait, and the UAE have had sizeable current account surpluses over the period between 1975 and 2011, Iran and Saudi Arabia have had marginal surpluses, and Iraq has had on average run deficits. Government budgetary balances would appear to be even more adverse from 1990 to 2010, with only Qatar and the UAE having a small budgetary surplus as a percentage of GDP during the period.

Although economic growth rates and their broad economic performance have been quite disappointing in these countries, their performance in the all-important area of human development, though better, has not been stellar. Although the value of the Human Development Index (HDI) of these countries is above the world average, only the UAE, Qatar, and Bahrain rank in the top 50 countries (Table 8.2). Moreover, since 1980, only Iran and the UAE have shown improvements in HDI values that have exceeded the world trend (Table 8.3).[5]

Although their performance has not been good, it is critical that the countries of the Persian Gulf appreciate the fact that oil is a depletable resource and that the window of opportunity, namely, high oil revenues, may begin to close over the next two decades. Thus it is important to change direction while they can. How countries fare over time is largely dependent on the quality and effectiveness of their institutions. Modern economic thinking, in a throwback to the writings of Adam Smith, stresses economic and political institutions as the necessary scaffolding for sustained development, something that

Table 8.2 HDI, 2011

HDI and its components								
HDI rank in the world	Country	HDI Value	Life expectancy at birth (years)	Mean years of schooling (years)	Expected years of schooling (years)	Gross national income (GNI) per capita (Constant 2005 PPP$)	Non-income HDI Value
30	UAE	0.846	76.5	9.3	13.3	59,993	0.813
37	Qatar	0.831	78.4	7.3	12.0	107,721	0.757
42	Bahrain	0.806	75.1	9.4	13.4	28,169	0.806
56	Saudi Arabia	0.770	73.9	7.8	13.7	23,274	0.765
63	Kuwait	0.760	74.6	6.1	12.3	47,926	0.705
88	Iran	0.707	73.0	7.3	12.7	10,164	0.731
89	Oman	0.705	73.0	5.5	11.8	22,841	0.671
132	Iraq	0.573	69.0	5.6	9.8	3,177	0.616
—	World	0.682	69.8	7.4	11.3	10,082	0.683

Source: The United Nations.

Table 8.3 HDI trends, 1980–2011

HDI rank	Country	HDI value					Average HDI rank change		Average annual HDI growth (%)		
		1980	1990	2000	2005	2010	2006–2011	2010–2011	1980–2011	1990–2011	2000–2011
30	UAE	0.629	0.690	0.753	0.807	0.845	3	0	0.96	0.97	1.06
37	Qatar	0.703	0.743	0.784	0.818	0.825	–1	0	0.54	0.54	0.53
42	Bahrain	0.651	0.721	0.773	0.795	0.805	–3	0	0.69	0.54	0.38
56	Saudi Arabia	0.651	0.693	0.726	0.746	0.767	0	2	0.55	0.50	0.55
63	Kuwait	0.688	0.712	0.754	0.752	0.758	–8	–1	0.32	0.31	0.07
88	Iran	0.437	0.534	0.636	0.671	0.707	2	–1	1.57	1.35	0.97
89	Oman	—	—	—	0.694	0.704	–2	0	—	—	—
132	Iraq	—	—	—	0.552	0.567	–1	0	—	—	—
—	World	0.558	0.594	0.634	0.660	0.679	—	—	0.65	0.66	0.66

Source: The United Nations.

cannot be overemphasized. As we have indeed emphasized in this volume, vast oil revenues without effective institutions in place ultimately undermine development. Without the rule of law and political accountability, vast oil revenues are too tempting a prize for most humans, especially for autocratic rulers and their supporters. Effective institutions would undermine their corrupt practices and ultimately their rule. This along with social and economic injustice, in our opinion, have been the most important factors (and all that goes with them) for economic, social, and political failure in these countries. Without effective economic and political institutions and justice, the future is likely to be as bad (dwindling oil revenues) as the past if not even worse.

In Tables 8.4 to 8.7, we see the performance of these countries in a number of important areas: rule of law, regulatory quality, government effectiveness, and control of corruption. Possibly the most important foundation for development, economic and political, is respect for the law or the rule of law—the notion that no one is above the law. In 2010, the absence of the rule of law was most apparent in Iraq, with a ranking in the bottom 10 percent of all countries; Iran was not much better and in the bottom 20 percent; and the GCC countries were all bunched together and significantly better in the sixtieth percentile, with Qatar in the seventieth percentile. Equally important, in some of the countries respect for the law has declined since 1996, and in others there was little improvement with the exception of Qatar, where there was significant improvement. In Table 8.5, we see the quality of regulations in the countries. Again, Iran and Iraq perform very poorly, and only Bahrain, Qatar, and Oman appear to have "acceptable" regulatory regimes. In Table 8.6, we see the percentile ranking for controlling corruption; again, Iran and Iraq perform very badly; and the UAE and especially Qatar, surprisingly to us, rate very high. In Table 8.7, we see the effectiveness and quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies; again, Iran and Iraq perform badly; and Qatar and the UAE do well.

In Table 8.8, we see the status of political rights, civil liberties, and the status of freedom. A glance at the table reveals what the sad reality is: political rights and civil liberties are almost nonexistent in the region, with the possible exception of Kuwait. We believe, as we have said before, that without political reform economic and human progress will be restricted and unsustainable. Simply said, the rule of law

Table 8.4 Rule of law percentile rank among all countries (ranges from rank 0 [lowest] to 100 [highest])

Country	1996	1998	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010
Bahrain	53	64.11	61.72	66.51	69.86	72.73	68.90	63.16	66.99	67.79	64.93	64.45
Iran	24	31.10	39.23	29.19	31.10	33.49	28.23	22.97	20.57	21.15	19.91	19.91
Iraq	5	5.26	9.09	4.78	2.87	0.48	0.48	0.96	0.96	0.96	1.42	1.90
Kuwait	65	68.90	66.03	66.03	65.55	65.55	66.99	66.51	69.38	68.75	65.88	65.88
Oman	67	69.38	69.38	65.07	65.07	68.90	60.77	61.24	64.59	71.15	68.72	67.77
Qatar	55	60.77	67.46	67.46	63.64	63.16	69.86	70.33	69.86	74.04	79.62	75.83
Saudi Arabia	59	59.33	50.72	56.46	59.81	57.42	56.46	55.50	57.89	58.17	56.87	60.19
UAE	67	73	71	71	68	65	63	62	60	65	63	63

Note: Reflects perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.

Source: The Worldwide Governance Indicators, the World Bank.

Table 8.5 Regulatory quality percentile rank among all countries (ranges from rank 0 [lowest] to 100 [highest])

Country	1996	1998	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010
Bahrain	68	72	74	76	69	74	71	72	73	74	74	76
Iran, Islamic Rep.	5	5	6	8	11	9	11	6	4	3	3	3
Iraq	1	1	1	1	7	3	5	7	7	13	17	16
Kuwait	55	43	45	63	64	69	64	61	61	57	56	55
Oman	49	47	54	72	71	71	66	68	70	73	70	69
Qatar	50	52	51	61	57	59	60	62	65	72	73	70
Saudi Arabia	47	42	51	51	56	56	56	53	55	56	57	56
UAE	75	71	75	83	71	76	71	70	71	70	66	63

Note: Reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private-sector development.

Source: The Worldwide Governance Indicators, the World Bank.

Table 8.6 Control of corruption percentile rank among all countries (ranges from rank 0 [lowest] to 100 [highest])

Country	1996	1998	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010
Bahrain	63	62	67	79	71	72	68	64	65	65	66	64
Iran	28	26	32	50	48	43	40	38	40	27	24	19
Iraq	2	4	3	2	8	1	1	1	1	1	3	4
Kuwait	78	79	81	84	83	82	72	72	71	73	67	67
Oman	61	77	79	80	70	72	64	62	66	70	69	68
Qatar	56	74	76	77	73	73	79	83	76	83	92	91
Saudi Arabia	28	29	40	60	51	46	54	49	54	58	60	63
UAE	56	58	63	85	81	85	83	79	83	83	80	80

Note: Reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.

Source: The Worldwide Governance Indicators, the World Bank.

Table 8.7 Government effectiveness percentile rank among all countries (ranges from rank 0 [lowest] to 100 [highest])

Country	1996	1998	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010
Bahrain	73	74	72	70	68	73	65	66	67	67	70	70
Iran	32	35	38	34	37	40	32	33	31	33	33	38
Iraq	1	2	2	1	1	2	1	0	3	9	9	9
Kuwait	60	53	52	60	60	61	62	63	56	57	59	59
Oman	70	71	66	67	69	69	64	64	65	67	69	69
Qatar	68	70	69	69	69	71	66	70	67	72	81	78
Saudi Arabia	46	47	46	45	44	45	40	49	52	53	50	53
UAE	73	77	78	77	72	77	74	79	80	78	77	76

Note: Reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

Source: The Worldwide Governance Indicators, the World Bank.

Table 8.8 Freedom average status and rating, 1975–2010

Country	1975–1980			1980–1985			1985–1990			1990–1995			1995–2000			2000–2005			2005–2011		
	PR	CL	Status	PR	CL	Status	PR	CL	Status	PR	CL	Status	PR	CL	Status	PR	CL	Status	PR	CL	Status
Bahrain	6	4	PF	5	5	PF	5	5	PF	6	5	PF	7	5	NF	6	5	PF	4	5	PF
Iran	6	6	NF	5	6	NF	5	6	NF	6	6	NF	6	6	NF	6	6	NF	5	6	NF
Iraq	7	7	NF	6	7	NF	7	7	NF	7	7	NF	7	6	NF	7	6	NF	5	6	NF
Kuwait	5	4	PF	5	4	PF	6	5	PF	6	5	PF	5	4	PF	4	5	PF	3	4	PF
Oman	6	6	NF	6	6	NF	6	6	NF	6	6	NF	6	5	NF	6	5	NF	5	5	NF
Qatar	5	5	NF	5	5	PF	5	5	PF	7	6	NF	7	5	NF	6	6	NF	5	5	NF
KSA	6	6	PF	6	6	NF	6	7	NF	7	7	NF	7	6	NF	7	7	NF	6	6	NF
UAE	5	5	PF	5	5	PF	5	5	PF	6	5	NF	6	4	NF	6	5	NF	5	5	NF

Notes:
– "PR" stands for "political rights," "CL" stands for "civil liberties," and "Status" is the "freedom status."
– "F," "PF," and "NF," respectively, stand for "free," "partly free," and "not free."
– Political rights and civil liberties are measured on a one-to-seven scale, with one representing the highest degree of freedom and seven the lowest.
– Until 2003, countries whose combined average ratings for political rights and for civil liberties fell between 1.0 and 2.5 were designated "free"; those between 3.0 and 5.5 "partly free"; and those between 5.5 and 7.0 "not free." Beginning with the ratings for 2003, countries whose combined average ratings fall between 3.0 and 5.0 are "partly free" and those between 5.5 and 7.0 are "not free."

Source: Freedom House.

and a favorable business climate will not take hold, and with vast oil revenues at stake, new rulers will in all likelihood follow the practice of those in power today—self-enrichment, cronyism, and collaborative colonialism—policies that have failed and will continue to fail, and policies that have fueled conflicts and wars and that will continue to fuel them.

In looking at how these countries have done and how well they might do in the future, some broad observations (as opposed to numbers) may be helpful. In the countries of the GCC, the outward appearance is that all the countries have gone through a dramatic change, or transformation, in the last 50 years; in fact, all of them bear very little physical resemblance, if any, to what they looked like 50 years ago—number of buildings, quality of infrastructure, and degree of wealth (although very unevenly distributed). But they have progressed little politically, and some may have even regressed. They have progressed far less than might have been expected in education, in creating a thriving private sector, and in building a diversified competitive economy. Iraq has been devastated. It is a country that has gone back decades, yet if it can establish political reforms and reconcile its sectarian and ethnic divides it might become a success story. In the absence of reconciliation, Iraq is doomed, and oil might in fact make reconciliation even more difficult. Iran lost a great opportunity after its revolution to adopt reforms and become an example to the region. Instead, ideology, rhetoric, and the need to consolidate the regime through political repression and inflammatory rhetoric targeting foreigners have meant that very little economic and social progress has been made. In 2013, the senior clerics are even contemplating closing conventional economics departments at universities until Islamic economics can be taught. The less-than-average conditions in Iraq and Iran along with simmering conflicts everywhere bode great dangers for the region.

Most important for the future, all the countries need effective institutions, especially the rule of law and political reforms, if they are to develop and avoid a continual cycle of conflicts and wars. It is here that the United States (and to a lesser extent the United Kingdom and France) must begin to see the light. US support for oppressive dictators in the practice of collaborative colonialism may bring short-run stability, but it will spell disaster for the future. To a large degree, it is US support that has impeded change. The United States must either put its narrow economic interests (and those of its lobbyists and companies) aside and work toward effective reforms in the region or stop its destructive interference. Oppressive rulers will

not change their policies unless they believe that without reforms they will be abandoned by the United States (the United Kingdom, France, Russia, and China also matter in this equation). Rulers are not facing the market price of the fallout of their policies. In fact they face a negative price. They are given every incentive to continue with what they have done to the detriment of their people. All of the above constitutes the fallout of collaborative colonialism.

Summary

The countries of the Persian Gulf have not fared well, politically, socially, humanly, and economically. Some countries have been transformed but none have developed. While oil revenues have afforded these countries unprecedented opportunities, most opportunities have been squandered. Rulers in the region and their cronies have put their personal financial interests ahead of those of their people and of the future of their countries. At the same time, foreign powers, principally the United States, have been unhelpful in supporting political and economic reforms that are absolutely essential. Rulers in the region, namely those in the GCC, have embraced the practice of collaborative colonialism to enrich themselves and their foreign supporters. All the while, the mullahs in Tehran have been on the outside looking in, attacking GCC policies and US collaboration and generally fanning the flames for their own survival; and Iraq is still in a state of flux, with no clear indication of where it will go as a nation over the next few years. Political, social, and economic reforms are urgently needed. Reforms are easier today while oil revenues are plentiful than they will be once oil is depleted.

Chapter 9

After Oil—Transition to Oil-Less Economies

Economic management in its current form is not sustainable in many, if not all, of the oil-exporting countries of the Persian Gulf. Government expenditures will in time outpace oil revenues as expenditures increase and oil revenues fall. Oil and gas are depletable, or wasting, assets. They should not be depleted to finance consumption. Saudi Arabia, perhaps, provides the best example. The country went from what was up to that time a record budget surplus in 1980, to a deficit in 1983, and it had continuous deficits for 17 years before returning to a surplus in 2000. And in 2008 it went from the largest budget surplus in its entire history to a deficit in 2009 before returning to a surplus in 2010.[1] When, not if, oil revenues begin to decline irreversibly, Saudi Arabia will experience continuous deficits if it stays on its present course. Iran's and Iraq's predicament could be even worse. Even the richer, smaller countries of the region—Kuwait, Qatar, and the UAE—may not be immune, because they may face external dangers if their three more powerful neighbors are confronted by economic failure and hardship. These problems will only be exacerbated and the opportunity for adopting reforms will become more limited as the demand for oil increases more slowly in the future, oil prices decline with increasing production of nonconventional crudes (from shale and tar sands), shale gas, and renewables, and the latter three become increasingly more competitive with hydrocarbons. This is a scenario that received much attention in 2012 after the International Energy Agency predicted that the United States would become a net exporter of natural gas by 2020, that it would be almost energy self-sufficient in net terms by 2035, and that North America would emerge as a net oil exporter by 2035.[2]

While a government's continuing budget deficit is an important measure of unsustainability, in the case of the Persian Gulf oil exporters (or any country that relies heavily on a depletable resource) such unsustainability has a much more ominous message. Imagine a country such as Japan. Japan would have problems if it were to run continuous budget deficits, but if in the future the problem was addressed by cutting expenditures or increasing revenues, it could quickly be resolved, with limited harm, as long as the deficits would decline and end in a reasonable period of time. But in the case of these oil exporters, when they run budget deficits while they are exploiting their oil reserves with significant oil revenues, the message is different. They ran deficits and they spent their oil revenues (revenues that they should have saved). But what has the depletion of oil and gas reserves achieved? It has possibly made a few people very rich and robbed the country (citizens of all generations) of its in-ground capital. They have lost something that will be hard to recuperate; they will have to work even harder than citizens of nondepletable resource-based economies to replace the capital that they have consumed. Thus the implications of budget deficits are different for an oil exporter than for a country such as Japan, because if an oil exporter runs deficits at a time when it is depleting its in-ground oil capital, its failure is more ominous. A country like Japan will be left with budget deficits, whereas the oil exporter will be left with budget deficits along with depleted capital, harming its economic future even more and with more unjust implications for future generations.

As we have stressed throughout this book, oil and gas reserves are an important part of society's stock of capital, especially in countries that rely heavily on depletable resources for economic output and exports, have harsh climates, and are endowed with little potable water and productive land. To be fair and just to all generations, oil and gas capital should be replaced by other capital and all members of society should receive comparable benefits from society's stock of oil. And this capital transformation, from oil to another form of capital, must be done efficiently and fairly for society's birthright to be preserved. What efficiently and fairly mean is important. Efficiently means that the oil is produced so as not to damage the field, using the best production techniques, when market conditions are most favorable, with revenues put into a temporary capital form that does not dissipate and depreciate, with nothing squandered (corruption), and finally in a more permanent capital form (financial or real) that grows in value, with a high rate of return. And fairly means that all citizens of all generations should receive the same benefit from the

exploitation of the depletable resource. One thing is sure; the ongoing oil depletion in the Persian Gulf will never achieve the goals of efficiency and equity. Using oil revenues for military expenditures does not transform oil to other capital! Rampant corruption impairs both efficiency and equity. Most current subsidies do not afford similar benefits even to citizens in the current generation, let alone those of future generations, because with so little capital transformation there will be no benefit for future generations. Giving free first-class education and health care to all in a few generations does not afford the same benefit to future generations when oil is depleted. We will elaborate on how true equity can be achieved below.

While the present course of economic management and oil depletion in the Persian Gulf countries is not sustainable, there are at least three factors that make conditions even worse. First, interstate and intrastate disputes and conflicts simmer in the region, with devastating fallouts in blood and treasure. As mentioned earlier, the Iran-Iraq War cost each of the two belligerents more than their total oil revenues in all the previous 12 years combined. Even more costly could be intrastate conflicts, such as the civil war that has raged in Syria. Such intrastate wars could erupt in almost any one of the eight Persian Gulf countries at almost any time. While today's conflicts are bad enough, they will also beget future conflicts because, unfortunately, reconciliation always appears to be elusive. Second, oil (and gas) revenues are uncertain and taking them for granted well into the future is sheer folly. This was confirmed in November of 2012, with the publication of the International Energy Agency's latest energy outlook mentioned above. Shale gas, shale oil, and oil from tar sands, along with the growing competitiveness of renewable sources of energy, have fundamentally changed the global energy picture and outlook. Shale oil and gas will ameliorate the transition to renewables while reducing the demand for conventional oil and gas. At the same time, Iraq's increasing oil output could have a major impact on the fortunes of other producers. Third, the high level of unemployment and of poverty alongside extreme opulence (oil-financed) and general hopelessness in the Persian Gulf region affords rulers less time for a turnaround than they might imagine.

We cannot help but begin by stating two obvious facts. First, and as we have stressed earlier in chapter 6, in all Muslim countries Allah is the Ultimate Owner of oil and gas resources. He has transferred the right of possession to humankind as trustees. No one person can own what is underground and bestowed by Allah to humankind of all generations. All resources must be developed in such a way as to

afford equal benefits to all generations, including the disabled. We realize that in some countries, in particular the United States, the landowner has ownership over the minerals underground. Not so in Islam and thus by law in all Muslim countries. Even land ownership is not absolute as already discussed in chapter 6. And in all Muslim countries, as far as we know, the law and the practice is that all depletable minerals belong to the state. Second, it is easier to undertake successful reforms the earlier they are implemented. Once all is depleted and oil revenues have been squandered, it will be too late. But it is never too early to start the reform process. Again, stating the obvious, earlier is better because there is more of the oil capital in the ground; there is more time and thus more flexibility to transition to an oilless economy; there is more time to create and nourish supportive institutions for sustainable economic growth and prosperity; and it is more likely that intrastate conflicts—sectarian, ethnic, and tribal—will have been contained.

Before even planning the transition to an oil-less economy, the fact that oil (gas) belongs to the people of all generations (not the rulers) and will be managed efficiently, equitably, and transparently for citizens of all generations must be publicly acknowledged by all rulers and governments in the Persian Gulf.

After establishing this obvious but elusive fact regarding oil ownership and the goals of efficiency and equity, countries need to establish the necessary structure and transparent governance to implement these goals. Yes, Iran and Iraq may say that this is in their Constitution and Saudi Arabia might say that this has already been stated in the Quran, but it is not something they live by and practice and it is not something they advertise to their deprived citizenry, much less to the world at large. The open admission of this well-known fact is immeasurably important as a step toward establishing societies that embrace social and economic justice. Citizens may at last feel that their grievances will be addressed. Hope may be restored. National policies to manage oil resources would have to be measured for the first time against these benchmarks—justice, equity, efficiency, and transparency.

Although revenue diversification for governments, a growing and diversified (output and exports) economy, and millions of productive jobs are needed in all these countries, governments must also develop policies so that citizens of all generations receive equitable benefits from oil depletion. In all of these countries, oil (gas) exports have provided the bulk of export receipts and of government revenues and these have fluctuated considerably from year to year because of the

volatility of oil prices. Relatively stable fiscal revenues are essential for stable macroeconomic management, for sustained economic growth, and for employment opportunities for citizens. To stabilize oil revenues, countries can, and have, adopted some form of oil stabilization fund. A portion of revenues is placed into the fund in a year in which oil revenues and prices are expected to be above average, and the monies can be "theoretically" drawn down when revenues and prices fall below the average. At the same time, an oil-exporting country could hedge its exposure to oil price volatility through the futures market. While such funds and hedging may be used to stabilize available oil revenues from year to year, this type of fund does not diversify the basic source of government revenues.[3] Government revenue diversification ultimately requires a healthy and growing economy with an efficient and effective tax system. As for jobs, the key is a healthy and growing private sector.

If the government uses oil revenues to establish infrastructure and publicly owned industries (that are, at least in name, owned by citizens of this and future generations), this would not fulfill the condition of affording equitable benefits to all citizens for a number of reasons: as the government uses oil revenues to build infrastructure and industries to compensate for oil depletion, some citizens in today's generation will receive more benefits than future generations; these benefits could be very large and could accrue to a few because of the pervasiveness of corruption in these societies; and most importantly, governments have proven inept the world over at choosing needed infrastructure in advance, at choosing competitive industries, and at managing industries efficiently to create productive jobs—there is no substitute for a healthy, productive private sector. The likely outcome would be infrastructure that may be underutilized while requiring maintenance; industries that are uncompetitive in the global marketplace without continuing subsidies; massive unemployment; a number of very rich rulers and cronies alongside deprived masses; and ultimately resentment, upheavals, and conflicts and wars.

A successful transition to a region of non-oil economies, with modern social and political institutions, must be founded on justice, good governance, efficient institutions, the equitable management of oil and gas resources to benefit all generations, and with foreign powers in a "supporting" role promoting reforms and regional reconciliation. To this end, the policies of the past must be rejected and there must be a directional change in the Persian Gulf while oil and gas reserves last. Without such a change rulers have no incentive to develop effective institutions. In fact, as we have elaborated in earlier chapters, they

(and the foreigners who support them) have every incentive to thwart the establishment of good institutions.

The basic institutional framework for achieving these ends is to create a transparent oil fund for all generations that will gradually take oil revenues away from the hands of governments and of rulers. As in any fund, this fund would have shareholders, but in this fund the names and number of all shareholders would be unknown today. Citizens of this and future generations are essentially the shareholders of the fund. Citizens would be regarded as the stakeholders in the collective ownership of natural resources, an ownership that must be preserved through their claims in the fund that will receive the proceeds of oil revenues as the oil and gas reserves are depleted. Assuming the equivalent role of depositors in a bank, each person would receive a just and fair return on his deposits. From a contemporary perspective, whatever gains society makes as a result of expanded production base, technical change, increased exploitation of natural resources, and economic growth, such gains should be evenly distributed among all members of society. For the first time, citizens would feel that they are the owners of their oil, restoring justice and fairness into their everyday lives and political outlook.

Some may ask how our proposal is different from existing funds in some of these countries? The approach of some countries, most notably Kuwait, Qatar, and the UAE (essentially Abu Dhabi) might wrongly appear to be the implementation of a policy to afford equitable benefits to all citizens of all generations. Although these countries have established significant (relative to their domestic populations) funds to provide a source of income for when oil and gas booms taper off, they miss the mark in a number of important ways. The rulers have not acknowledged the ownership of the oil and gas resources, nor have they essentially admitted that they have no prior claims to the oil and the revenues that it generates. This is a crucial point. In the absence of an unquestionable ownership structure (belonging equally to citizens of all generations), rulers can take, as they have done in a number of Persian Gulf countries, from oil revenues at will; and governments can also take what they need for any and all expenditures (subsidies to buy domestic support, acquisition of arms, and a multitude of other unproductive and wasteful expenditures) and in the process compromise the rights of future generations of citizens. Additionally, we propose that gradually all oil revenues be deposited in the proposed fund. Moreover, the objectives of these existing funds (commonly referred to as SWF) are not in the least clear. Our goal is to afford every shareholder (now and in all future time) the same real

annual financial payment in the context of a transparent fund. The management of existing funds in these countries is not transparent. We propose an independent management with no government connection and with annual reporting of all results to its stockholders, the citizenry. The books of our fund would be open to all citizens as equal shareholders.

As for the governments that have largely relied on oil revenues for their expenditures, it would be unreasonable to expect them to go from plenty to zero overnight. We propose a transition period of 10–15 years depending on the country, during which government revenues from oil would gradually decline to zero. A transition period would afford governments sufficient time to develop an effective and equitable tax system. Just imagine where these governments would be if they did nothing until oil ran out in 20 or 30 years. This is something that they should be doing now anyway. The de-linking of oil revenues from government coffers should also reduce other problems, such as the high level of military expenditures, which is likely to be associated with civil wars and conflicts. Conflicts in turn lead to higher military expenditures, capital flight, loss of social capital, slower economic growth, and more poverty and refugees—an almost impenetrable vicious circle. We believe that our fund, which in time will take all revenues away from the government, should be an integral and primary component of any template to manage natural resource depletion in all developing countries, especially those that profess Islam. However, in the scheme outlined below, we could still envisage a fixed percentage (small) of the total payout of the proposed fund going to the government for specific infrastructural or social programs.

How would the fund benefit each and every citizen equitably? The essential idea is to give each citizen, every year from now until the end of time, the same real annual payout. Of course this cannot be done exactly but it can be made close enough.[4] The real annual payout could be readily calculated and continually updated, as a moving average, to reflect changes in the oil and gas markets and country population and population projections. A small cushion could also be built into the fund to safeguard its integrity against any catastrophic shortfalls; and, as mentioned above, a small fixed percentage of the fund's annual payout could go to the government for specific and predetermined programs. Individuals would be in a position to save or spend their money (share of the oil resources) as they wished, the most efficient way to transfer benefits to the citizenry. And most importantly, all the while, oil capital has been transformed, preserved, and

not dissipated, as is the practice now. While governments cannot pick winning industries, individuals can. Entrepreneurial citizens would initiate investments and others would become investors. Jobs would be created and governments would be forced to become both efficient and accountable because they would rely on taxes for revenues to provide essential services, as do most countries in the world.

When such a fund is established with transparent and effective governance, it would serve as an example for the institutional scaffolding that countries need. These would include the rule of law, effective business regulations and enforcement, clear property rights and their legal protection, equitable and effective taxation, protection of human freedoms and rights, and accountable government structure. At the same time, taking oil revenues away from the government will motivate governments to adopt consistent economic and financial policies. We would expect less foreign meddling in the region because transparency would trump the ability of rulers to reward foreign backers. The oil gusher that feeds foreign support would dry up to a dribble. Rulers would be motivated to reform as opposed to enriching themselves. Thus the likelihood of other reforms would increase and popular resentment of rulers and their backers would decline.

In short, we believe that establishing such a fund would turn the political economy of oil in the Persian Gulf, as we have represented it, on its head. This fund would be the catalyst for fundamental political and economic reforms in the region, and would reduce foreign meddling as well as ethnic, sectarian, and tribal conflicts. Operational details would need to be carefully considered. They have to be tailor-made to accommodate each country's human, social, and political realities. Importantly, the operational features should be designed to provide equitable benefits from oil depletion and to give appropriate incentives to individuals to live productive lives.

What are some of the operational, social, and economic issues that need to be considered in the process of establishing the oil fund that we have recommended to share the benefits of oil and gas depletion equitably between all citizens of all generations? While there are numerous details that would have to be developed on a country-by-country basis, here we summarize a few of the considerations that may be important in designing the operational aspects of the fund.

(a) The Beneficiary

A number of these countries, especially those that are more sparsely (and richer in oil/gas) populated, have a significant expatriate

population. One option is that only citizens would be the beneficiaries of any payout from the fund because the oil could be assumed to belong only to citizens.[5] Should payments be based on a minimum age, say 18? Should the payment be made to the parent or the guardian of a minor? If yes, then such a policy could encourage population growth (and the more children one has, the larger the share of the fund's payout).

(b) Moral Hazards and Conditionality

One could propose instituting compensating factors that would serve to minimize unintended consequences. Specifically, the first payment from the fund could be tied to some socially acceptable (or desirable) criteria. For instance, for those in the 18–30 age bracket, the first and subsequent payouts could be made conditional to achieving a minimum level of education, or to having a history of productive and legal employment if not attending school. Another condition could be the maintenance of a clean civilian record. Depending on the nature of the offense, a felon might forfeit his or her right to further payouts from the fund.[6] Another interesting application of the fund is to explore the design of the fund to mimic the role that social security plays in wealthier countries. These and other features could have a significant effect on a number of related factors, such as birth rates and savings rates.

(c) Societal Productivity

An obvious attack on a fund such as ours is that individuals would become lazy, that in the process society would become less productive, and that social malaise and decadence would permeate the social fabric. These are all legitimate concerns. But if governments develop effective institutions, adopt rational and consistent economic policies, and generally provide a supportive business climate, citizens will be more motivated (and will have the resources) to invest and invigorate private-sector growth.

(d) Investments, Payouts, and the Use of Resources

The payout objective of our fund would have to be set with the ultimate goal of making reasonably constant and fair payouts to current and future generations. To that end, the fund should invest in a

diversified portfolio of real and financial investments across a broad range of countries, currencies, asset classes, and non-oil industries. The size of the payout would need to be recalculated periodically and the various input assumptions would need to be pegged to some predetermined moving average, as is the case in the State of Alaska. In this way, all citizens of future generations would receive annual payments that are roughly the same in real purchasing power.

(e) Effective Tax Policy

The success of such a fund also depends on an efficient system of taxation. Yet none of the Persian Gulf oil exporters have an effective income tax system to address social and economic needs (Iran has an ineffective tax system, while the others do not have any type of income tax system in place). Given the monumental waste of oil revenues over the last 40 or so years, it is clear that much more thought is required on how oil revenues should be used and what form of tax system would best meet the needs of current and future generations in order to address efficiency, simplicity, and fairness (social justice).

(f) Administration

The operations of the fund would have to be transparent, with no special claim to its holdings by anyone, including ruling families. The fund would need clear independence and authority with respect to investment decisions and general management. These requirements cannot be overemphasized. Norway's oil fund is exemplary in this regard.

(g) Governance and Control

A fundamental concern with establishing such a national fund has to do with its governance. The governance body (possibly a board of directors not dissimilar to a modern corporation) should comprise individuals with a balance of skills, experience, and independence; and the membership of one or two respected foreigners on the board may be even desirable. Mandatory and periodic disclosures with respect to the fund's assumptions and modeling (details of its calculations for academic scrutiny), balances, investment policies and results (profit and loss and balance sheet), flow of funds, and personal financial disclosures of the board members would instill public confidence and minimize potential malfeasance. Further, the rights of citizens (annual meetings, voting, etc.), the fund's beneficiaries, would have

to be clearly articulated and upheld. Effective internal control mechanisms would have to be put in place.

(h) Provision of Government Services

Some may find our proposal objectionable because crucial government services could be reduced or even eliminated. They argue that governments should have access to "some" oil revenues in order to provide services that are universally expected of a government: education, health care, retirement, and public safety. Yes, governments should provide at least some of these services, but they should finance them through income taxes that are fair and efficient. More specifically, in many of the countries, payouts from the fund would be sufficient to cover private funding of education, health care, and retirement.

We are hesitant to provide numbers for what payouts could look like as these will depend on the assumptions that are made, but we provide some earlier calculations based on much lower prevailing oil prices. The payout to citizens basically divide the countries into three groups: 1. Iran, Iraq, and Oman; 2. Saudi Arabia (with Bahrain largely dependent on Saudi assistance); and 3. Kuwait, Qatar, and the UAE.[7] The payouts are highly significant for all the countries and especially so for the last group. Depending on the assumptions (such as developments in Iran and Iraq, eligible recipients, and the question of whether Abu Dhabi would share with the other emirates), we believe that the annual payout in 2013 dollars would be in the $5,000–10,000 range for the first group, the $20,000–40,000 range for the second group, and the $60,000–200,000 range for the third group. These are big numbers. But again, if these countries waste and wait, the payout will be smaller. And if the actions of these countries fuel conflicts, all bets are off. Again, as with anything else, the sooner such a fund is adopted the better, because the benefits would be higher.

Summary

The ongoing course of economic management in the eight oil-exporting countries of the Persian Gulf is unsustainable. With oil depletion, the wealth (capital) locked in oil resources is not being replaced by another form of capital for future generations. As things are, the benefits of oil cannot be justly shared among all citizens of all generations.

The only way to exploit oil resources to equitably benefit citizens of all generations is through a transparent oil fund that weans governments from oil revenues, invests the proceeds, and affords every citizen the same real annual payout. We firmly believe that this is the only approach to lay the foundation for a sustainable turnaround in the countries of the Persian Gulf, because:

1. It would reduce the incentive for rulers to seek absolute powers, adopt oppressive policies, and thwart the development of effective institutions.
2. It would encourage foreign powers to play a more helpful role in the region.
3. It would restore the important element of justice into Persian Gulf societies—something that is at the very core of Islamic teachings—and bring hope to the region.
4. It would provide incentives to establish and nourish effective institutions and to build the strong foundation needed for political, social, and economic reforms.
5. It would reduce the likelihood of interstate and intrastate conflicts and wars.

Such an equitable approach to the management of oil resources will become a reality only if it is supported by international agencies, NGOs, and academics, and given international recognition by the media. It would turn the political economy of oil on its head, with the role of oil transformed from enriching rulers, their cronies, and their foreign supporters and fueling conflicts and wars, to supporting desperately needed political, economic, and social reforms, and encouraging human development in the region.

Chapter 10

Conclusion

Ever since its discovery a little over a hundred years ago in Iran, oil has shaped political, social, human, and economic developments in the Persian Gulf. Although oil has financed modernization or transformation, it has not financed development, and has preempted political, social, and economic reforms. Oil has drawn foreigners, especially the world powers as colonialists and neocolonialists, to the region in search of economic and financial spoils. Oil has fueled ethnic, sectarian, and tribal conflicts and wars. And yet, the final impact of oil on each of the eight countries that share the Persian Gulf may turn out to be very different when the last drop of oil is extracted than where they find themselves in 2013. The political economy of oil has been gradually shifting from what was effectively colonialism to what has become collaborative colonialism.

Before the export of oil and the flow of oil revenues, these countries and sheikhdoms were poor and weak. They were, as were most other underdeveloped countries, ripe for exploitation by the imperial powers. Iran was somewhat different, because it had been an independent country for centuries and had not been colonized. Iran had a constitutional revolution early on in the twentieth century and was well endowed with other resources besides oil, including productive agricultural land and water. The Iraq that was created in the twentieth century, although not an independent nation state as Iran had been for centuries, had its own long history as Mesopotamia. However, the specifics of its demarcation in the twentieth century guaranteed that sectarian and ethnic divides would plague its very existence and viability as a modern nation state. The other six countries in the Persian Gulf were new creations. The Al-Sauds conquered all the other tribes in Arabia to create Saudi Arabia, a country that had no revenues before oil besides the expenditures of pilgrims. The other countries

had been nothing more than sparsely populated desert sheikhdoms, with little more than subsistence economies based on fishing and pearl harvesting. Without the inflow of vast oil reserves, the countries of today's GCC (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE) undoubtedly would not have acquired the apparent façade of development—high-rise buildings, over-the-top projects, and opulent wealth. Before oil they were poor. Without oil, they most likely would still be poor and would not have the trappings of a modern state. Ironically, Iran and Iraq, the two countries that might have been expected to fare better because of their non-oil endowments and history, have fared worse. They might well have been better off without oil. Although the benefits of oil were still hardly visible until well after World War II, oil was to physically transform all these countries beyond recognition.

Before the discovery and growing importance of oil, the eight countries of the region were of very limited interest to foreigners. The interest of foreign powers, initially Great Britain and Russia, in Iran was strategic. Russia's concern was access to the warm waters of the Persian Gulf and trade routes. Great Britain wanted control of the Persian Gulf as the means to safeguard its important colonies, principally India, and to protect its global trade routes. Great Britain considered the Trucial States, Qatar, and Bahrain as useful alternative (to Iran) bases of operation in the lower Persian Gulf. Thus in the nineteenth and early twentieth centuries, the great powers saw these countries purely as means to other ends and treated them accordingly. But oil gradually changed the equation. The Persian Gulf took on global economic importance in its own right. Much later in the twentieth century, the United States entered the fray; European powers expanded their presence in the region; and Russia and more recently China have been keen to safeguard their growing economic interests in the region. While the United States had relied on Iran, and later on Iraq, as surrogates in the Persian Gulf, in 1990 and in the aftermath of the Cold War the United States established its own massive presence in the region. Persian Gulf countries and waters became critical in their own right. The interference of so many foreign powers changed the political, social, and economic developments of all these countries and the face of the region as a whole. Oil changed, and will continue to change, the history of these countries and the history of the world.

From the discovery of oil early in the twentieth century up to the end of World War II, when Iran, Iraq, Kuwait, and Saudi Arabia were exporting oil, oil companies dictated their terms to oil-producing

countries on a take-it-or-leave-it basis, something that was most vivid in British dealings with Iran, the country with the longest history of oil production in the region. The companies totally controlled and determined oil exploration, production, and the sharing of profits in these countries. The oil companies did not share the most basic of business information, such as profit and loss statements, with the countries. The threat of oil boycotts and military interventions were vivid and real, because the companies operated with the full support of their imperialist governments. The imperialistic exploitation of the Persian Gulf—colonialism pure and simple—was bound to fuel popular resentment of foreigners that would continue in the minds of citizens for generations.

Still, during most of the period before the formation of OPEC in 1960, the rulers and governments of these countries did what they could to get a fair share for their countries and something for themselves. They were negotiating from a position of weakness. In time, their bargaining position was strengthened by market conditions—growing global demand for oil, an increasing OPEC share of world production and exports, the entry of independent oil companies with very limited sources of crude (thus more vulnerable) into international markets, and a strengthening of the financial position of the oil-exporting countries. The oil-exporting countries replaced the cartel of the major international oil companies, or the "Seven Sisters," with their own cartel of the OPEC.

All along, the major oil companies and the Western countries that supported them became accustomed to dealing with absolute rulers. In the process, they discovered that it was easier to make a deal with a corrupt strongman than with a representative government that was answerable to the people. So in support of their companies, Western governments backed the strongmen in the name of stability, the free flow of oil, and moderate oil prices. These dealings poisoned relations between the citizenry and foreigners for years to come, in some countries even today. At the same time, the cooperation of Persian Gulf leaders with foreign governments, coupled with their corrupt rule and extravagant lifestyles, alienated the citizenry from their own leaders. Foreigners and rulers had become almost one and the same. Although most former colonies were cut loose and left to their own devices to develop in fits and starts after World War II, the countries of the Persian Gulf were instead reigned in because of their oil resources. They were prevented from reforming. After all, experimenting with change could have turned violent. Instead, foreigners stepped up their support of oppressive rulers in the name of stability

to bottle up popular demands for reform; colonialism morphed into collaborative colonialism.

Although OPEC was formed in 1960 to combat declining oil prices, it was the dramatic changes in the global oil market (higher share of world production and exports and the proliferation of independent oil companies) that afforded the Persian Gulf producers increased bargaining power. The US-Saudi Agreement undermined the British position in the Persian Gulf. Increasingly after World War II, the countries dared, or were forced, to confront the oil companies because of domestic resentment, but in return they got more retribution than before. Iran and later Iraq were to pay a heavy price for taking an aggressive stand with oil companies. The British approach with Iran and later with the revolutionary government in Iraq was much harsher than that of the American oil companies with Saudi Arabia.

For much of the period from the discovery of oil into the early 1970s, foreigners were the major determinants of the political economy of oil in the region. In those earlier years, all the way from the discovery of oil up to the price hikes of 1973–1974, the major oil companies were the face of foreign power and intrigue in the region. The people did not perceive their rulers as "villains" throughout the period up to the mid-1970s, a fact that was to change in the future. But increasingly since the mid-1970s, resentment became redirected toward the oppressive rulers and the foreign governments that backed them. More and more, the rulers of most Persian Gulf countries began cooperating with foreign powers to enrich themselves and their foreign backers, a policy that could only undermine their rule and fuel popular resentment against the Westerners. In the aftermath of the price increases of 1973–1974, popular economic expectations exploded. The people had waited for decades and they wanted tangible benefits. Unfortunately, rulers and governments took the selfish and easy route—inefficient, wasteful, and unsustainable subsidies to buy popular support, but with ominous implications to come, especially for the countries that were less endowed with oil on a per capita basis. And subsidies once given would be very hard to eliminate.

Flush with cash, Iran, Iraq, and Saudi Arabia also bought more and more arms. Saudi Arabia also supported US efforts in other ways. The Al-Sauds gave special price discounts to the United States as a sign of gratitude for the Camp David Accords and gave fuel to the US navy even during the Arab Oil Embargo. Oil and political support for Al-Saud rule were intricately linked from the start.

As the oil companies warmed up to unelected strongmen rulers they could control, rulers could not help but notice that they could

count on the support of powerful foreign governments as long as they supported their commercial and financial interests. Relations had become a two-way street between the international oil companies and the rulers. A representative parliament might demand transparency and accountability and might not deliver on what had been agreed to behind closed doors. A revolutionary government had to deliver on exaggerated promises to wrest control from foreigners and would be less likely to compromise. Foreign governments, principally Britain and the United States, supported the interests of their oil companies in the region, using intrigue and even military might. After Britain's departure from the region in 1971, and especially after the Cold War, the United States became the principal foreign power in the region and the country with the greatest interest in its oil. But foreign force took a different form. Before the mid-1970s, foreigners threatened force against governments in oil-producing countries, but since about 1980 and especially since 1990, foreigners have used force in support of these governments.

OPEC came to global attention with the Tehran Agreement in 1971, with the Arab Oil Embargo and the ensuing shortages and oil price increases in 1973–1974, and during the Iranian Revolution, with perhaps the most dramatic spike in oil prices in 1979. Although it was generally recognized that the tightening oil market—OPEC's growing share of global oil production and exports—was the underlying reason for price increases in 1971, in the latter two periods, the price increases have been attributed to disruptions and incorrectly, in our opinion, to OPEC production management and cutbacks. In effect, price movement had less to do with OPEC unity than with market supply-demand developments. OPEC's heyday was during the period between 1969 and 1974. Today, it is global demand-supply conditions and major conflicts and disruptions that matter. In the aftermath of the Iranian Revolution, a period that also witnessed the Iran-Iraq War and disruptions to the flow of Iranian and Iraqi oil, the major and prolonged decline in prices was due to changed market conditions. OPEC could do nothing to prop up prices in the face of dramatic changes in global energy supply and demand. Moreover, major OPEC members had little or no political reason to coordinate their oil production policies. OPEC was more of a façade than an effective cartel. The political differences among members may become even more pronounced in the future, with the GCC camp on one side and the Iran-Iraq camp on the other. For Saudi Arabia, oil pricing and production policy is closely tied to international and regional political realities as well as to how prices will affect long-term demand. For

Iran and Iraq, in desperate need of revenues, it is short-term revenues that are important for survival.

The only possibility for cooperation and coordination in the foreseeable future depends on dramatic changes in the political structure of Iran, Iraq, or Saudi Arabia, or on the majority of OPEC members facing serious financial crises that threaten the survival of those in power. In all these countries, especially in the richer countries of the GCC, the rulers have made an implicit agreement with their subjects; in return for their subservience, their rulers will provide them material benefits—health care, education, employment, and income. But this is something that none of them may be able to afford forever. Qatar, Abu Dhabi, and Kuwait may be the possible exceptions, but even they may face financial constraints a few decades down the line unless they manage their oil wealth better to compensate for oil depletion. In 2013, political considerations may be perceived as more important than oil revenues for survival to the rulers of the GCC, but this is shortsighted. Massive subsidies cannot be financed forever and citizens will increasingly resent the disparity of lifestyles that oil has financed in these countries.[1] Under these circumstances, the impact of OPEC actions on prices may be largely inconsequential and OPEC's time as an effective organization may have passed with the Iranian Revolution in 1979, if not earlier by 1975.

Although there was a dramatic recovery in oil revenues after 2000, the lessons of the period between 1983 and 2000 should not be forgotten. Oil prices and revenues can drop as quickly as they rise. If revenues are wasted in times of plenty, then governments may have little choice but to borrow to finance consumption subsidies if they wish to keep the general citizenry at bay. Moreover, deficits may reduce their ability to buy foreign support, be it through major contracts, arms imports, or though direct payments for services. Most importantly, the lesson of the 1980s and the 1990s is that the ongoing policies of most major oil exporters in the Persian Gulf (with the possible exception of the very rich, namely, Qatar, Abu Dhabi, and Kuwait) are unsustainable. The sooner they make radical changes, the easier it will be for their survival. If they change now, while revenues are still bountiful, they may be able to keep their domestic constituencies content, buy foreign support, and stay in power. Today in 2013 they still have room for maneuver. But they will need political as well as economic reform to be successful in the longer term.

The period between 2001 and 2013 has been, and may continue to be for some time, the longest era of high and sustained oil prices and revenues for the oil-exporting countries of the Persian Gulf (except

for Iran, plagued by economic sanctions). It has also been a period of dramatic political change in the region and in the broader Middle East: the widespread consequences of the 9/11 attacks; the toppling of the Baathist regime in Iraq and the rise of a Shia government in Baghdad; the war in Afghanistan; violent regime changes in Egypt, Libya, Tunisia, and Yemen; civil war in Syria; violent suppression of popular demonstrations in Bahrain; demonstrations in Kuwait and in the eastern province of Saudi Arabia; popular demonstrations that turned violent against election fraud in Iran; perceived threats of Iran's nuclear program; tightened UN, US, and European sanctions on Iran; violence in the Kurdish regions of Syria, Turkey, Iran, and Iraq; Turkish meddling in search of cheap oil in the Kurdish semiautonomous region of Iraq; and the continued presence of a large contingent of US forces in the region. Indeed, it is possible that Turkey might seize the opportunity to support Iraqi Kurdish independence and secure its own oil needs for years to come, with a new configuration of conflicts to follow. Today in 2013 the biggest sources of change are the spillovers of the civil war in Syria, a breakup of Iraq, an international war with Iran over its nuclear enrichment policies, and the overthrow of absolute rulers in the GCC. Any of these could result in a sharp spike in oil prices and mass destruction, with reconstruction to follow.

In the end, economic success or failure is likely to be the main factor shaping the political economy of oil in the Persian Gulf and in the greater Middle East. The citizenry see their valuable oil benefitting only a few while many cannot even find decent jobs. Will the benefits of oil improve lives more or less equitably and in line with expectations, or will oil continue to enrich a few and leave the rest with only a memory of what might have been? Oil revenues will at some point decline. How will these nations then face the future? If other forms of capital do not replace oil and if the economic benefits are not significant and equitably divided as oil is depleted, domestic and regional turmoil can but only grow. The implicit contract with subjects in the GCC—material benefits in exchange for subservience—may no longer be sustainable. Oil depletion must be more just and result in equitable benefits for all generations. Sustained economic prosperity must be accompanied by fundamental political reforms. In the absence of political reform, economic success will be short-lived, because economic and social justice will not take hold. New rulers must not be allowed to take on the mantle of the overthrown rulers and enrich themselves and their cronies. Political and economic reforms will have to go hand-in-hand for the region to flourish.

Oil has been a factor, directly or indirectly, in all regional developments, and these regional developments have, in turn, affected oil policies in the region. While on one level the landscape of the region has dramatically changed over the last 50 or so years, on another level it would appear that little has changed. Oil revenues are still wasted. The economic foundation for post-oil economies has not been established. Sectarian, ethnic, and tribal divisions continue to grow as conflicts ravage the region. Most depressing in this regard are the growing Shia-Sunni divide and the Saudi-Iranian split. Oppressive rule is the norm. Political reform is but a mirage. Effective institutions, especially the rule of law, are but a dream. But without simultaneous economic and political reform, the region will be in a state of continuous turmoil, with no hope of an economic turnaround. In the absence of an economic turnaround, conflicts and wars to capture oil and gas resources could be the region's destiny. The window of opportunity afforded by oil may close in the next 15–20 years if it remains unaccompanied by positive change and development.

Is Islam a problem, or is Islam an integral part of the solution? In the Islam of the Quran and the Hadiths, to ensure the property rights of all members of society, ownership of natural resources is placed in trust of the state or the community, to be used equitably for the benefit of all humankind in all generations, with justice as the foundation. Neither should rulers nor should any other groups receive a disproportionate benefit. Institutions, rules, and rule enforcement are the foundation of society. While Islam preaches justice and the equitable sharing of benefits of natural resources between all humans and all generations, oil has upended all that. Oil has soaked the social, political, and economic fabric of these societies, all of which bear no resemblance to the Islamic vision.

The persistence of autocratic rule brings overarching fallouts for the citizens of countries of the Persian Gulf: absence of political, economic, and social reforms; subpar economic performance; objectionable income distribution and poverty; and pervasive injustice. As a result, we see widespread and growing dissent and hopelessness in the region. Popular resentment has become increasingly directed toward oppressive rulers, with radicals and terrorists targeting foreign supporters. We have seen some of these grievances played out all over the Arab World between 2011 and 2013. While the conservative monarchies of the Persian Gulf have managed (with the exceptions of Saudi Arabia and Bahrain) to keep the lid on uprisings, the question is for how long?

What would have happened in the absence of foreign interference and support for oppressive rulers? We can only imagine. Yes, there

would have been more instability in most, if not all, of the countries, but better institutions would have gradually developed over time. We believe there would be more freedom, more elected and answerable governments, and more progress toward developing civil societies. There would have been fewer interstate wars and much less destruction. To us, what is frightening is not the past, but the future. A turnaround will require the absolutely unselfish participation of the United States and other foreign parties. Although the United States has already paid a heavy price in blood and treasure in the Persian Gulf, future costs could far exceed what we have seen to date.

As we have seen, the performance of the Persian Gulf countries has been disappointing in almost every imaginable dimension. These countries should have used the capital that is locked up in their oil to diversify their economy, to enhance economic growth and human development, to build efficient institutions, and to transform oil into other forms of capital to provide equitable benefits to all future generations. Instead, they have had subpar per capita income growth. They have not saved sufficient oil revenues and have instead run budget and current account deficits, all the while depleting their oil resources.

The ongoing course of economic management, or more accurately mismanagement, in the eight oil-exporting countries of the Persian Gulf is unsustainable. These countries are depleting their oil, but are not replacing oil capital for future generations. The only way to equitably benefit citizens of all generations while exploiting oil resources is through a transparent oil fund that weans governments from oil revenues, invests the proceeds, and affords every citizen of every generation the same real annual payout. We firmly believe that this is the only approach to lay the foundation of a sustainable turnaround in the countries of the Persian Gulf. The goal of such a fund would be: to reduce, and possibly eliminate, the incentive for rulers to seek absolute powers, adopt oppressive policies, and thwart the development of effective institutions; to encourage foreign powers to play a more positive role in the region; to restore the important element of justice in Persian Gulf societies—something that is at the very core of Islamic teachings—and to bring hope to the entire region; to provide incentives to establish and nourish effective institutions; to lay a strong foundation for political, social, and economic reforms; and to reduce intrastate and regional conflicts. Such an equitable approach to the management of oil resources will become a reality only if it is widely recognized and supported.

We cannot overemphasize the fact that the countries of the Persian Gulf are caught in a vicious cycle of oppressive rule financed by oil

revenues and supported by outside powers. The incentive is to preserve the status quo because any meaningful reform would undermine unrepresentative governments and oppressive rulers. Hereditary rulers are not willing to contemplate a transition to constitutional monarchies, nor are dictators willing to relinquish their hold on power. The reason is simple—the vast riches of oil revenues. For now, rulers can bottle up dissent with the support of foreign powers. But for how long? The early history of oil in the region was effectively characterized as colonialism, but it has evolved into what is today "collaborative colonialism." Citizens resent foreign powers and the rulers who cooperate with them. A sustainable turnaround will require concerted effort on a number of fronts—economic, social, and political—on the part of rulers, foreign powers, international institutions, and NGOs, all of which must recognize that the status quo is unsupportable, that drastic reforms are essential, and that the practice of "collaborative colonialism" must come to an end if we are to avoid a catastrophe in the region.

Notes

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77. Shwadran, *The Middle East*, p. 430.
78. Ibid.
79. Hay, "The Impact of the Oil Industry on the Persian Gulf Shaykhdoms," p. 369.
80. Sorkhabi, "The Qatar Oil Discoveries."
81. Ibid. p. 434.
82. Ibid.
83. Hay, "The Impact of the Oil Industry on the Persian Gulf Shaykhdoms," p. 369.
84. Ibid.
85. Ibid.
86. Ibid. p. 370.

Appendix: Oil—Facts and Prices

1. *BP Statistical Review of World Energy June 2012*.
2. IEA, *World Energy Outlook 2012*, 2012.
3. *BP Statistical Review of World Energy June 2012*, p. 15.

3 Before Oil—Political and Economic Conditions in the Persian Gulf

1. I have to admit that this was an unusual position for someone of Iranian descent, given historical suspicions and animosities between Iranians and Saudis. But I had left Iran at a very young age and had put roots down in the United States as a tenured professor at the University of Texas at Austin.
2. For more details on this discussion, see Askari, Hossein and John Cummings, *The Economies of the Middle East in the 1970s: A Comparative Approach* (New York: Praeger, October 1976).
3. For a technical economic analysis and a number of references for assessing OPEC market power, see Huppmann, Daniel, and Franziska Holz, "Crude Oil Market Power—A Shift in Recent Years?" *The Energy Journal* 33, no. 4 (2012).
4. The only cases of OPEC members helping another oil exporter (though not an OPEC member) has been Saudi Arabia's financial support for Bahrain, mentioned in chapter 2, and GCC financial support for the United States to evict Iraqi forces from Kuwait.

4 Oil—The Turbulent Years (1979–2001)

1. For details, see Askari, Hossein, *Conflicts and Wars: Their Fallout and Prevention* (New York: Palgrave Macmillan, July 2011, Chapter 5).
2. For further details, see Askari, Hossein, Amin Mohseni, and Shahrzad Daneshvar, *The Militarization of the Persian Gulf: An Economic Analysis* (Northampton, MA: Edward Elgar Publishing, December 2009).
3. These numbers were estimated from the figure on oil prices in British Petroleum, *BP Statistical Review of World Energy* (June 2012), p. 15. Retrieved March 26, 2013, http://www.bp.com/assets/bp_internet/globalbp/globalbp_uk_english/reports_and_publications/statistical_energy_review_2011/STAGING/local_assets/pdf/statistical_review_of_world_energy_full_report_2012.pdf.
4. For details on the size and budgetary burden of subsidies, see Askari, Hossein, *Saudi Arabia: Oil and the Search for Economic Development* (Northampton, MA: Edward Elgar Publishing, 1990).
5. See Al-Dukheil, A., *Saudi Arabia Earnings and Expenditures: Financial Crisis in the Making* (New York: Palgrave Macmillan, 2013).
6. The regimes in Iran and Iraq have been more receptive to adopting harsh methods on a national level in dealing with their population, whereas Saudi Arabia has done so only with its Shia citizens.
7. International Energy Agency, *World Energy Outlook 2012* (Paris: OECD/IEA, November 2012).

5 Oil—The Most Recent Years (2001–2013)

1. See Askari, H., *Conflicts and Wars: Their Fallout and Prevention* (New York: Palgrave Macmillan, July 2011).
2. Ibid. Table 5.7, p. 144.
3. According to an analysis by the Center for Strategic and International Studies, October 2010, http://csis.org/blog/saudi-arms-deal-links-nonproliferation.
4. According to Arms Control Association, May 1998, http://www.armscontrol.org/print/360.
5. According to *Financial Times*, September 2010, http://www.ft.com/cms/s/0/ffd73210-c4ef-11df-9134-00144feab49a.html#axzz1TzGdV6rG.
6. "Washington considers selling bunker-busting bombs to UAE," *The Telegraph*, November 14, 2011.
7. According to the Global Military Index (GMI) as reported by Bonn International Center for Conversion (BICC).
8. See appendix in chapter 2 for the impact of these factors on supply and demand.

9. See International Energy Agency, *World Energy Outlook 2012* (Paris: OECD/IEA, November 2012).
10. The author is currently working on a book with the title *Conflicts in the Persian Gulf: Origins and Evolution*, to be published by Palgrave Macmillan in 2013.
11. For a full discussion of Saudi revenue-expenditure decisions and their consequences, see Al-Dukheil, Abdulaziz, *Saudi Arabia Earnings and Expenditures: Financial Crisis in the Making* (New York: Palgrave Macmillan, 2013).

6 Oil—Islam, Ownership, and Instituti ons

* This chapter borrows from: Mirakhor, Abbas, and Hossein Askari, *Islam and the Path to Human and Economic Development* (New York, NY: Palgrave Macmillan, August 2010;) Askari, Hossein, "Oil Rents, Political and Military Policies, and the Fallout," in *Handbook of Oil Politics*, Robert E. Looney (ed.) (London: Routledge, December 2011); and Askari, H., F. Abbas, G. Jabbour, and D. Kwon, "An Economic Manifesto for the Oil Exporting Countries of the Persian Gulf," *Banca Nazionale Del Lavoro Quarterly Review* 59, no. 239 (December 2006).

1. Solow, Robert M., "Intergenerational Equity and Exhaustible Resources," *The Review of Economic Studies* 41, Symposium on the Economics of Exhaustible Resources (1974), p. 41.
2. Again for more details on Islamic economic principles, see Mirakhor and Askari, *Islam and the Path*; and Askari, Hossein, and Roshanak Taghavi, "The Principal Foundations of an Islamic Economy," *Banca Nazionale Del Lavoro Quarterly Review* 58, no. 235 (December 2005).
3. The transition to oil-less economies and the details of a policy that incorporates intergenerational equity is taken up in some detail in chapter 9.
4. British Broadcasting Corporation (BBC), "Norway Oil Wealth Fund Made Big Gains in 2012," accessed on March 10, 2013, http://www.bbc.co.uk/news/business-21733474.
5. See Mirakhor and Askari, *Islam and the Path.*

7 Oil—Foreign Interference

1. Harden, Blaine, "Saudis Seek U.S. Muslims for Their Sect," *New York Times*, October 20, 2001, referenced by Bard, Mitchell, in *The Arab Lobby: The Invisible Alliance that Undermines America's Interests in the Middle East* (New York: Harper, August 2010).
2. Bard, Mitchell, *The Arab Lobby*, p. 162.
3. *Near East Report*, June 23, 1976, p. 109.
4. Akin Gump Strauss Hauer & Feld LLP ($220,770), Boland & Madigan ($420,000), Burson-Marsteller ($3,619,286), Cambridge

Associates ($8,505), Cassidy & Associates ($720,000), DNX Partners ($225,000), Dutton & Dutton ($3,694,350), Fleishman-Hillard ($6,400,000), Gallagher Group ($612,337), Iler Interests ($388,231), Loeffler Group ($10,349,999), Loeffler Tuggey Pauerstein Rosenthal ($2,350,457), Loeffler Jonas & Tuggey ($1,260,000), MPD Consultants ($1,447,267), Patton Boggs ($3,098,000), Powell Tate ($900,732), Qorvis Communications ($60,314,803), and Sandler-Innocenzi ($8,885,722); Bard, *The Arab Lobby*, p. 173.
5. Ibid. p. 175.
6. Bard, *The Arab Lobby*, p. 307.
7. Askari, Hossein, Amin Mohseni, and Shahrzad Daneshvar, *The Militarization of the Persian Gulf: An Economic Analysis* (Northampton, MA: Edward Elgar Publishing, 2009), Chapter 4.
8. Bard, *The Arab Lobby*, p. 99.
9. *The Economist*, "Storm Survivors," Offshore Finance Special Report, February 16–22, 2013, p. 4.

8 Oil—The Fallout in the Persian Gulf

1. *Source*: The World Bank
2. "JEDDAH: More than 12.5 million workers in the Gulf Cooperation Council (GCC) countries are foreigners, accounting for 31 percent of the 40 million GCC populations, the latest official study said. Three million foreigners are domestic workers in the six GCC member states. The expatriate labor is not distributed uniformly in these countries. While 30 percent of the Saudi Arabian population is expatriate, in Bahrain it is 26 percent. Expatriates account for 80 percent of the population in the United Arab Emirates, while they constitute 27 percent in Qatar, 63 percent in Kuwait and 62 percent in Oman. However, some other studies claim that the actual number of expatriate workers in the GCC is about 15 million, Al-Hayat daily reported yesterday," Arab News, September 11, 2012, http://www.arabnews.com/expat-population-%E2%80%98could-threaten%E2%80%99-gcc-security.These percentages of expatriate populations are in our opinion low, especially for Qatar, where we estimate the expatriate population to be over 85 percent.
3. *Source*: The World Bank
4. http://www.reuters.com/article/2012/03/28/saudi-unemployment-subsidy-idUSL6E8ES2S020120328
5. Islamic teachings stress human development as an essential component of development and the foundational requirement of effective institutions, rules, and rule enforcement. The Persian Gulf countries have not performed well on such an Islamic index: Rehman, Scheherazade and Hossein Askari, "How Islamic Are Islamic Countries?" *Global Economy Journal* 10 no. 2 (May 2010); and "An Economic Islamicity Index," *Global Economy Journal* 10 no. 3 (September 2010).

9 After Oil—Transition to Oil-Less Economies

1. See Al-Dukheil, Abdulaziz, *Saudi Arabia Earnings and Expenditures: Financial Crisis in the Making* (New York: Palgrave Macmillan, 2013).
2. International Energy Agency, *World Energy Outlook 2012* (Paris: OECD/IEA, November 2012).
3. The exceptions are countries that are so rich that they can invest a large portion of current oil revenues in diversified assets (abroad) to give their governments all the revenues they need in the future, without having to resort to taxation.
4. For details, see Askari, H., F. Abbas, G. Jabbour, and D. Kwon, "An Economic Manifesto for the Oil Exporting Countries of the Persian Gulf," *Banca Nazionale Del Lavoro Quarterly Review* 59, no. 239 (December 2006).
5. The definition of "citizen" is itself a complex topic. For instance, in most countries a noncitizen spouse of a citizen could elect citizenship status. If that were the case, would the spouse who was recently granted citizenship be entitled to the same payout from the fund in the same manner as the indigenous? What about extended families of the spouse?
6. Here, the money that would have been paid out to felons may instead be redirected to law enforcement bodies and also to finance prisons, rehabilitation centers, and so on.
7. See Askari et al., "An Economic Manifesto," 2006. Bahrain and Oman were omitted in this earlier study.

10 Conclusion

1. See Askari, H., *Saudi Arabia: Oil and the Search for Economic Development* (Northampton, MA: Edward Elgar Publishing, 1990) for a detailed calculation of subsidies in Saudi Arabia and their long-term economic implications.

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