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# Growth Problems in Wealthy LDCs

by Professor Klaus E. Rohde, Erlangen \*

**Large revenues drawn from oil offer wide scope for a highly active development policy, especially to the oil producing states round the Arab-Persian Gulf (which is to be understood as a geographical, not a political term). But even countries in such a favoured situation experience bottlenecks, and also the direction in which their economic and social structures of the future may move is full of pitfalls.**

There is no doubt that oil is the biggest business of our age, a development which is closely tied up with technological problems, changes in economic structure, the evolution of both national and international economic systems and, last but not least, the shifts in international politics. The main oil-producing countries in the Persian-Arab Gulf, but also elsewhere in the world, now experience, in addition to their close integration in the worldwide power network of international politics and of trade policy in the highly complex field of oil economics, their subjection to a host of complicated problems of development policy on their own territories. Only some of these are made clearly visible by statistical returns on national incomes, their production and their uses. In order to be able to discover the special slant of a local situation and to discern local views on development policy and its aims, it will always be necessary to make careful studies in depth in the countries concerned and to cultivate close contacts with the local policy makers and to observe local social stratification. The multitude and diversity of impressions and bits and pieces of information available on the spot can be briefly classified and interpreted under a number of main headings.

## Foreign Exchange Earnings

Statistical returns on income per head of population make it appear that countries round the Persian-Arab Gulf, including Kuwait, Saudi Arabia, Qatar, Bahrain, and Abu Dhabi, are ranking already among the "rich" nations of the world.<sup>1</sup> Consequent upon the Teheran agreement between host countries and foreign oil companies, which was made in February, 1971, on important changes in reference data for calculating oil revenues of

producing countries, this income will again rise substantially. Nevertheless, there can be no doubt that also these "rich" countries are definitely developing countries — not only because national income in them is often distributed in a highly inequitable fashion but because of many typical traits in their social and economic makeup: an underdeveloped transport infrastructure, their lack of education, technological and organisational knowledge and skill, their poor public health administration, and the presence of whole groups of the population which are not fully integrated, nationally, linguistically, and socially in the body politic. Even though *one* of the conventional indicators of underdevelopment may move in an atypical way—in this case per capita income—this does not automatically lift a less developed country into the developed state. On the contrary, this discrepancy sets up special development problems. In the countries concerned, these discrepancies are usually clearly seen, and they lead to special incentives for political decision making.<sup>2</sup>

## Strategy of Development Policy

Since the wealth of oil producing countries flows largely from a single source, from which they draw a high income in foreign currencies, this makes it necessary to search for possibilities of rational spending. Before a *practical* strategy and *practical* projects of short and longer term private and public investment can be hammered out, such countries must establish *general aims* for their development. One of the first questions to

<sup>1</sup> Cf. "World Bank Atlas (Population, Per Capita Product, and Growth Rates)", published by the International Bank for Reconstruction and Development, 1970.

<sup>2</sup> Because of the much earlier start of its economic development, Iran is not a typical developing country, also because of its vast size, and of its highly diversified economic structure.

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be settled is the decision as to whether a given producer state is to become a "nation of rentiers" or will build up a modern economy with a developed infrastructure and highly diversified production. The actual decisions that are most likely to be taken in such countries seem to be generally those in favour of building modern economies, as all the indications and pronouncements of planning board members and others government agencies in Kuwait, Bahrain, Qatar, and the larger Trucial sheikhdoms on the Gulf reveal.<sup>3</sup> Evidently, this generalised aim is supported by almost all the social groups in these countries, though, of course, with different preferences for important incidental variations of policy. The main motivations for this fundamental consensus on the basic lines along which development policies are to move seem to be the following:

☐ There is widespread doubt in the permanence of an economic yield of their single source of national wealth, which is crude oil, though in most cases, no sign has yet appeared that reserves are nearing exhaustion (except, for example, in Bahrain). However, another kind of scepticism seems to be justified, namely whether demand might not, one future day, shift both regionally (towards supplies from Alaska and from oil shale processing in the US) and technologically towards substitution of oil by rising output of atomic power stations, and thus put a brake upon the rates of growth for oil revenues in a number of countries with crude production. There are indeed already certain signs that the latest success in pushing crude prices up may stimulate the long-term competition by substitutes for oil and thus tend to price crude out of the energy market, where it is now the only source of wealth for producing countries.

☐ Former bazar traders and nomads show genuine *ambition* to be able to demonstrate that they themselves may prove capable of jumping on the bandwaggon of modern industrialised societies and their kind of progress.

☐ Both social psychology and considerations of local policy make it appear inadvisable to tempt the majority in a community, who until recently used to live at the brink of starvation, to become idlers in a welfare state. On the contrary, the economic policy aim is to produce rising income from *productive* employment.

In many developing countries, the *main bottleneck* of development is the scarcity of liquid funds, but

in the "rich", but largely severely underdeveloped Gulf states, this is not the main cause of worry. If Professor Harrod's theory of growth were correct that it is mainly the rate of savings which determines the rate of economic growth, the sheikhdoms of the Middle East would be easily capable of achieving high growth rates, provided their production was sufficiently diversified. Actually, however, the implied assumption of Harrod's (and other economic theorists) that "capital manning" will always be guaranteed under conditions of limited use of factors (and even of limited factor substitution) can only be seen to be true in economies of the northern industrialised type, where there are sufficient reserves of skilled operators, but not in the desert sheikhdoms of the Gulf. In order to establish advanced industrial techniques and a satisfactory organisation of service industries there, it is necessary to import foreign workers with the most diverse skills, including skilled industrial workers, experts in administration, doctors, etc.<sup>4</sup> These needs of production created by the accepted aims of development are, however, inseparable from certain social tensions and local and foreign policy problems. The intelligentsia and especially the political leadership groups of host countries tend to make much of these problems both for the present and the future, though individual judgment of persons may lead to differing forms of expressing them, as follows:

#### Aid by Foreign Experts — a Two-Edged Sword

☐ What are the practical possibilities for distinguishing between expatriate foreigners, who are applicants for permits of residence and of employment, some of whom may be pure adventurers on the search for making their fortunes in rich states, and others whose skills and knowhow fill gaps in the local labour market for shorter or longer periods, or who bring with them business initiatives or are able to teach the local population?

☐ As numerous expatriates have been working for a long time already in the economies and in the administrations of Kuwait, Bahrain, Abu Dhabi, and of other sheikhdoms on the Gulf, it may be expected that they themselves, knowing that they are needed for making growth possible, aim at a higher status in the local political and social pyramid of the host country.

☐ The share of expatriates from Egypt, Iraq, etc., where political and social systems prevail that are very different from those in the sheikhdoms,

<sup>3</sup> Cf.: Government of Kuwait, The Planning Board, "The First Five Year Development Plan, 1967/68-1971/72", also, from the same source: "Kuwait Economy in 1969/70. A Survey"; Government of Abu Dhabi, Directorate-General of Planning and Co-ordination, "Five Year Development Plan, 1968-1972"; Government of Bahrain, Department of Finance and National Economy, "Statistical Abstract 1969"; Statistical Bureau, August 1970.

<sup>4</sup> Cf., inter alia: State of Kuwait, The Planning Board, Central Statistical Office, "Statistical Abstract 1970", Sections II, III, and V.

in the total labour force is high. Their home countries live on a lower level of prosperity, and this combination might, for various reasons, lead to international political tensions of several degrees of intensity. It is hoped, however, that the Pan-Arabic idea and certain institutional ties, e.g. the OPEC, might be able to ward off conflicts from these sources.

### Promotion of Labour-Intensive Production

In view of the known bottlenecks in the labour supply of Gulf states for building up new economies with highly diversified production, it appears that the *following growth strategies* (with certain variations) make good sense:

□ In a number of production branches, e.g. petrochemicals, and in major divisions of the administration, foreign experts are being used to enable a high-level technology and organisation to be established. The aim is to expand this "modern area" of operation progressively.

□ In order to strengthen the *national* element in these heterogeneous economies, the Gulf states endeavour to settle the nomads among their inhabitants. Nomads often do not feel as yet to be members of a definite nation state under a fully integrated administrative machinery, which does not, however, imply an adverse judgment about the level of their civilisation. In and near the national capitals, extensive housing projects go up for the people whom it is intended to settle in fixed abodes, and they are impressive parts of the new infrastructure, even though they may not fully correspond, in the beginning, with the psychological needs of persons who have been used for centuries to completely different modes of life.

□ Their high oil revenues make it possible for Gulf sheikhdoms to train those parts of their population who are not immediately suitable for employment in the designed economy of the future, without demanding of them, in the initial stages, high degrees of productivity from their employment. That is why their governments do not only favour the growth of the "modern sector", consisting of oil production, transport, processing, petrochemicals, banks, etc., but also investments of both local and foreign capital owners who employ a high share of labour. This labour-intensive kind of investment agrees with development principles drafted by ILO. In the long term, the running of such a vast "vocational school and technical college" will train up local skilled labour, later to be used for expanding the modern sector or substituting the foreigners, who work in these sectors<sup>5</sup>.

<sup>5</sup> Cf., inter alia, Abdul Malik al Hamer, "An Analytical Study of the System of Education in Bahrain, 1940-1965", Bahrain, 1969.

In contrast to this kind of development, poorer developing countries generally endeavour to use their capital resources for building up industries of high immediate productivity. But as this requires an advanced technology, the problems of creating new employment and of vocational training are rarely tackled satisfactorily. Thus, in Brazil, the Sudene-Condepe development agencies strain all their energies to concentrate modern and highly profitable new production in the impoverished East, especially the North-East. Unemployed parts of the local population, who will not find employment in these plants, are to be channelled into the third sector of the economy. In order to apply a theory of growth effectively in developing countries, it will thus be necessary to take care of the human element not only in general terms and explicitly, but to vary the policy, sector by sector, according to their diverse functions in production.

### Favourable Growth Effects

It is not possible to paint from simple growth figures of a given economy, even if the observer distinguishes between their various causes, a precise picture of their effect on the welfare of the community. In order to see clearly, it is necessary to study both quantifiable growth rates and *welfare* functions, but to determine the latter for a collective raises both difficult basic problems of logic and specialised tasks of collecting information. On the one hand, it will be decisive, in this context, how *decisions* are formed by conscious acts of will among different decision makers regarding public investment projects (in transport, education, public health, defence, etc.),<sup>6</sup> and on the other hand, it is necessary to measure the *effect of spending*, in real terms, on the growth of popular welfare. This might be interpreted as the problem of how to buy most at the lowest price through budget appropriations: if graft or overcharging by foreign building contractors (who like, of course, to tender for projects in richer countries) lead to deliveries or services of inferior value, this reduces the value added, in real terms, which has been budgeted for at cost in the national accounts. On the whole, it is possible to say of the Gulf states (though to a lower or higher degree in individual ones) that putting out contracts to tender and the scrutiny of bids through technical experts who, as persons, seem to judge without fear or favour, appears to have improved the overall situation considerably, compared with other developing countries.

<sup>6</sup> Cf. Abu Dhabi Planning Board, "1971 Annual Programme", January 1, 1971; also the parallel programmes of other states on the Gulf.

How to market, both locally and internationally, the products, more and more of which become available from manufacture using modern technology, after capacities which have already started up and those which are planned have begun to operate at full capacity, is a problem that looms differently over different sectors. Part of the output of both capital and consumption goods will find its market in the countries of origin. But in some cases, capacity is much larger than national income and demand, for foreign currency earnings of these plants are intended to supplement and, later, to replace oil revenues. Fertilizers—manufactured in petrochemical plants—are already in danger of future regional oversupply, Afghanistan, for example, already making its weight felt as competitor. Obstacles to international trade also limit exports very much, within the region and beyond. Due to the pressure for supplies of desulphurized oil and gas, under new environmental legislation, prices of elemental sulphur have dropped in world markets under the weight of oversupply e.g. the Iranian sulphur plant at Bandar Shahpur is already facing profitability problems.

#### **Problems of Future Market Outlets**

Therefore it appears to make sense that individual states on the Gulf have already made a start in obtaining equipment for modern transport and port handling, in the interest of their future balance of trade and services, so as to earn more from their harbours and shipping. This revives and modernizes their traditional functions as entrepôt traders and middlemen, based on their favourable geographical location, with the aid of modern techniques and organisation — e.g. in the cases of Bahrain, Dubai, and Kuwait.

In spite of growing diversification of the Gulf states' own production, also their demand for imported goods is steadily expanding in line with the increase of their national income. What is being demanded are both goods for individual consumption and means of production, and this demand also supplies guiding lines for planning local investments, though, fortunately, the Gulf states do not suffer from the panicky psychology of import substitution, because they continue to be amply supplied with foreign currency. (Countries suffering from foreign currency shortages frequently display a hectic longing for autarky. In most cases, it is completely irrational, because forced local production, which can only be built up behind a high wall of protection against imports, becomes so uneconomic and expensive that the upward pressure on prices acts in a vicious circle, thus spoiling potential export pos-

sibilities. The ultimate effect is, on balance, a further drain on export earnings, instead of savings.)

Direct foreign investments round the Gulf are possible both in the form of setting up wholly-owned foreign companies or of joint ventures and partnerships with local investors — not only in the oil industry but in many other fields, which may also increase the import of technological knowhow and skills. Nevertheless, big international companies of world renown only rarely establish production subsidiaries around the Gulf, because local markets are too small for them. The application of modern techniques and organisations like in their country of origin requires minimum production volumes for which local outlets (perhaps for machine spare parts or electrical fittings in Kuwait) are, on the one hand, too narrow, and from where, on the other hand, because of local barriers against imports, exports to the rest of the Gulf region and beyond are extremely difficult. This is why big groups prefer to channel their exports of many products directly from industrial countries, e.g. the US, Japan, the UK, into the states round the Gulf. This effect of their geographical location is unfavourable for industrial planning in those states, from various aspects. It would therefore be highly advisable for them to dismantle the barriers they themselves have built up against import trade, in order to create larger markets over an extensive economic area.

#### **Administration to Replace Tribal Chieftainship**

Modern developments set up many forces, which have a starkly disruptive effect materially and which increase emotional tensions among and within people. Some fundamental changes in traditional modes of thinking and of doing things are becoming necessary for replacing an entire old civilization by a new one, and more transformations of a similar kind are being imposed by the changed surroundings of people dwelling on the Gulf. Of particular significance is the shift in the leading strata which run the Gulf sheikhdoms: modern planning of their economy and a proper public administration require institutional and personal foundations that are wholly different from traditional tribal chieftainship, which has been the function of the sheikhs and emirs until only one generation ago (and in some cases up to very recent years). Rulers nowadays rule through a planning board, through specialised government departments. But through the growth of authority in the hands of individual departments and agencies, local and international obligations and risks are bound to grow, too.