Economics of Oil and Its Stability in the Gulf Region

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***Abstract*—**After the World War II, the world economy was disrupted and changed due to oil and its prices. The research in this paper presents the basic statistical features and economic characteristics of the Gulf economy. The main features of the Gulf economies and its heavy dependence on oil exports, its dualism between modern and traditional sectors and its rapidly increasing affluences are particularly emphasized. In this context, the research in this paper discussed the problems of growth versus development and has attempted to draw the implications for the future economic development of this area.

***Keywords*—**Oil prices, Gulf Cooperation Council, economic growth, Gulf oil.

I. Introduction

AFTER the Second World War, there was a sea-change in the organization of the international economy [1], [2]. The pre-Second World War international economy was territorially balanced and integrated. This is manifested in the theoretical work on international economics which has emphasized "one world model", or an integrated international economy [3]. Despite this preference for one world model, the actual international economy was moving in a different direction. In place of a strong unifying economic force of integration, there was a force of regional disintegration. After the Second World War, the emergences of regional blocks were found which were contrary to the spirit of a single integrated international economy. The ideas which were at the level of discussion were given a concrete form in the year 1957 by forming a European Economic Community (EEC) and Free Trade Area. It was the same concept in the socialist countries of the Eastern Europe where they form a similar block in 1949. It was called communist Economic Council (Comecon) or Council of Mutual Economic Aid (CMEA) as described officially in socialist countries. Similar trend was also observed in the less developed countries of Latin America which formed their own economic block called Latin American Foreign Trade Association (LAFTA). It was observed that the well-knit, well-balanced and integrated world economy of the pre-Second World War was undergoing a fundamental and structural change in the direction of regionalism. The aim of this study is to concentrate on the economics of oil in Gulf and to focus on oil production [3].

The paper is useful for the academic community, educational institutions, and business sectors. The paper is a good read for literature students of business studies. The research paper is helpful for those government institutions who are involved in the economic aspects of Gulf Cooperation Council (GCC) integration processes from central government to the municipalities and other stakeholders to gain a greater knowledge and understanding of this complex process.

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II. OPEC and Oil Economies

The winds of structural change were naturally affecting other regions of the world. The Gulf countries were no exception in this respect. Furthermore, the Gulf countries were more susceptible to and well-prepared for such union because there was already a strong unifying cultural and political affinity among them. They had the common heritage of a religion, cultural and political system. But the political situation in the gulf region immediately after the Second World War was not fully developed for adoption of such economic union. Saudi Arabia had complete political autonomy since 1932 but other countries like Kuwait, Bahrain, Qatar and other principalities were still under the foreign rule. There was an atmosphere of political uncertainty and expectancy in these countries till the process of independence started in Kuwait in 1961, and eventually all the remaining countries were freed by 1971. When this factor of political uncertainty was resolved, the Gulf countries spontaneously moved towards economic re-organization. But the States maintained close contact and discussed the prospect of some collective section again the political thread in this strategic area [3].

Before independence, the Gulf oil resources were monopolized and controlled by the international oil companies which paid low royalties for drilling rights, leaving the Gulf Countries little revenue compared with the high profits of the companies. This economic exploitation ended with the attained of full independence of the Gulf Countries. The Governments of these countries took partial or full equity holding in oil companies and converted the oil sector into a national oil sector. They were guided and helped by the Organization of Petroleum Exporting Countries (OPEC) which controlled production and pricing policies to protect the interest of the oil producers. Under the leadership of the OPEC, the crude prices were stepped up in accordance with the rising world oil demand of the industrial countries. Table I gives the extent of the prices rise, the effect of these price change was an enormous increase in the revenues of the Gulf Countries. The dependence of these countries on the oil revenue was the only source to finance administrative, welfare and development expenditure. With a sudden and substantial step-up in their resource position, the countries faced with a new problem of newly earned surpluses. The dimension of this problem can be indicated by some representative data on the growth of oil revenues of Gulf Countries from 1950 to 1983 [3].

TABLE I
CRUDE OIL PRICES, FROM 1970 TO 1983 [2]

Day	Month	Year	Oil Prices $ per Barrel
---	---	1970	1.80
15	February	1971	2.18
22	January	1972	2.48
1	January	1973	2.59
1	October	1973	3.01
16	October	1973	5.12
1	January	1974	11.65
1	November	1975	10.46
1	October	1976	11.51
1	July	1977	12.70
17	December	1978	Agreed to rise of 10% in the Price of Crude Oil from 1st January 1979.
1	January	1979	13.97
1	October	1979	14.54
At	Beginning	1980	24.00
---	------------	1980	34.00
At	Beginning	1981	36.00
---	------------	1982	36.00
---	------------	1983	29.00
---	------------	1986	10.00
---	December	1986	18.00
---	------------	2001	23.12
---	------------	2007	69.04
---	------------	2011	107.46
---	------------	2015	49.49

TABLE II
OIL REVENUE OF THE GULF COUNTRIES, 1950 TO 1983 US MILLION DOLLARS [4]

Year	Bahrain	Kuwait	Oman	Qatar	KSA	UAE
1950	88	156	2	17	272	2
1960	152	800	2	101	720	2
1970	219	1921	165	189	1939	440
1973	326	3057	264	568	7270	1441
1975	918	7347	1133	1447	23741	5576
1976	1109	7878	1253	1767	30630	6838
1977	1476	7814	1268	1599	34772	7766
1978	1515	8342	1278	1856	32573	7323
1979	1990	14733	1824	2995	50742	10876
1980	2878	15883	2998	4558	87289	16542
1981	3478	13038	3757	4553	96192	16192
1982	3033	8689	3537	3402	63294	13806
1983	2560	8822	3398	2707	87553	11677
2001*	2500	24000	8000	2700	88555	11000
2007*	2500	2880	7150	2700	10555	12000
2011*	3500	2508	5500	2700	11000	12500
2015*	3050	2780	12024	2055	11624	12800

* estimated according to the new references that are seen by the same authors [4].

Tables I and II prove that the countries have experienced an exponential growth in their oil revenues. Thus, there are two exogenous factors motivating these countries to adopt wider perspective of economic development. The first is the political independence and the second is the economic strength. The Arabian Gulf Countries were well-poised for a take-off to further economic progress. However, this progress could not be an automatic progress as visualized by classical and new-classical economies, but has to be modeled deliberately to achieve certain objectives in the future.

III. Regional Economic Integration in GCC

There is extensive literature on the problem of regional integration. The theory of economic integration is discussed by [5] which is further followed by a number of other economists who are [6]-[9]. In the works of these economists, the acceptable meaning of the term regional economic integration was found. There are two major streams: liberal and dirigisme model. In one sense, economic regional integration is defined “as a process and as a stable of affairs. Regarded as a process, it encompasses measures designed to abolish discrimination between economic units belonging to different national states; viewed as a state of affairs, it can be represented by the absence of various forms of discrimination between national economies” [7]. This interpretation of regional integration is regarded as a liberal integration. It implies that regional integration would mean absence of discriminatory impediments on free movement of factors of production goods and services between the different nations belonging to a region. In other words, the liberal ideal presupposes restoration of the economic condition of the free trade and free market which approximately existed before the First World War In view of this interpretation a free market mechanism is one which allow the market forces of supply and demand a free scope to work out the allocation of resources according to the principle of comparative advantage. However, these ideas have continued to influence thinking on economic integration in terms of free trade area, custom union and common market. The formation of the European Economic Community represented the concrete expression given to such liberal ideas [10].

The liberal view identified regional integration with trade and payment liberalization. It means a state of affairs in which the market mechanism functions perfectly and needs no state-intervention. This position is opposed by the German and French economist’s viz., [11], [7] who have argued that state intervention is an essential part of regional integration. The problem like the avoidance of depression, the maintenance of full employment, the problem of regional development the regulation of cartels and monopolies, and so forth are important to be considered. The market mechanism by itself will not be sufficient to reserve the problem of full employment cyclical instability and economic development on a regional plan. These economists argue that regional integration presupposes coordination of economic policies of the member nations. Thus, they allow state intervention and even state development plan as an essential feature of regional integration [7], Even the League of Nations study on customs unions published immediately after the end of the Second World War recognized that regional integration will increase the state intervention in economic affairs. This dirigisme version may be expressed by the term regional coordination to emphasize its state intervention bias.

IV. Regional Coordination in GCC

The destination between regional integration and regional coordination is in our opinion, not just semantic. In our opinion the dirigisme ideas of regional integration and regional coordination are identical. If the European Economic Community represents the liberal ideas, this means that the Council for Mutual Economic Assistance (CMEA) represents the regional coordination. In the CMEA model the national economies of the member are coordination by an administrative and non-market mechanism like the national economic planning. The economic plans of the different nations are coordination through 'Comprehensive Programmed of Socialism Integration' in addition to the centralizing force, there is another feature of the CMEA. There is the supreme economic power of the USSR which brings about overall rigorous coordination among the members. This aspect of regional integration as most of the studies is based on the experience of the market economies. However, from the point of view of developing countries of the third world, this coordinating mechanism cannot be ignored, especially when dealing with the problem of regional cooperation among the Gulf Countries.

V. Synthesis of Integration & Coordination

Having clarified the concept of regional integration and regional coordination may proceed to focus our attention on the concept of regional cooperation. The term regional cooperation has not been defined or clarified in the relevant literature as it is a comparatively recent phenomenon. Also, [12] mentions that this term was first used in the United Nations Economic Council for Latin America.

It was mentioned in the discussion of the post-Second World War regional integration as a relationship which was distinct from regional integration; for instance, [5] states that his concept of regional integration does not cover agreements and regional cooperation. His concept of regional integration was mainly expressed in terms of the elimination of discriminatory impediments on the movements of factors of production and on foreign trade. In one sense, this was a negative approach to regional integration. Similarly, the concept of a regional coordination excluded regional cooperation because regional coordination implies a process of economic centralization by a supreme authority like the supranational planning authority. Such authoritarian coordination of the nations, economies is ruled out in the framework of regional cooperation. By regional cooperation means a process or a state of affairs where the separate and autonomous national economies are coordinated through influence and consensus among the members for achieving some common political and economic goals [7]. In this process though centralization of the state economic plans is ruled out, there is a scope for increasing participation of the Governments of the members of the regional block in some collective action to achieve regional objectives. This broad meaning of regional cooperation has incorporated both the liberal trend as well as the dirigisme streams of the concept of regional integration [7]. On the one hand, there is a liberalization of the attitude towards reversal of discriminatory practices. In the traditional concept of regional integration there was a stress on eliminations of all discriminatory practices. However, in our interpretation of regional cooperation, discriminatory subsidization by the economically stronger nations in favor of the economically weaker nations is an essential aspect of regional cooperation. The distinct trait is also present in the concept of regional cooperation in a modified form. In the traditional concept of regional coordination there is an element of a centralized agency represented by a supreme power proving the coordinating mechanism. In contrast to this power-based coordination, in regional cooperation there is coordination through the mechanism of beneficial usually by a senior partner who is the leader of the regional block. This tentative definition of regional cooperation has some important implication. First, regional cooperation is not a phase in a progressive process which subsequently develops into integration and later into coordination. It means that the difference between regional cooperation, on the one hand, and regional integration and coordination on the other hand, is not a difference of degree but is a difference of kind. That is, regional cooperation is quite a distinct type of economic relationship among a small group of countries which is based on equal participation and willing subsidization. This new model of regional cooperation manifested in the form the Gulf Economic Council, which is the main focus of this research paper.

TABLE III
International Organizations [13]

Year	Title of the Organization	Name of the Countries signed
1957	European Economic Community 'EEC'	France, West Germany, Italy, The Nether-land, Belgium and Luxembourg.
1959	Free Trade Area European Free Trade Association 'EFTA'	Austria, Denmark, Norway, Portugal, Sweden, Switzerland and United Kingdom.
1949	CMEA	Bulgaria, Czechoslovakia, GDR, Hungary, Poland, Romania and USSR.
1948	LAFTA	Cistercian, Guatemala, Honduras and Nicaragua.
1960	Montevideo Agreement	Argentina, Bolivia, Brazil, Chile, Mexico, Peru and Uruguay
1969	Andean Sub-regional Group	Bolivia, Chile, Colombia, Ecuador and Peru
1959	Custom Union for Western Africa	Dahomy, Upper Volta, Mali, Mauritania, Niger, Senegal, Tango and Ivory Coast.
1961	East African Community	Kenya, Tanzania and Uganda
1961	South East Asia Organization	Malaysia, Philippines, Thailand, Indonesia and Singapore
1981	GCC	Saudi Arabia, Kuwait, Bahrain, Qatar, Oman and UAE.
1984	South Asia Association For Regional Cooperation" SAARC'	India, Pakistan, Sri Lanka Maladies & Bangladesh

VI. Disparities in Oil Resources

So far this research has referred to the six countries as a block and has observed that this block represents a producer and exporter of oil in the world. Along with this concentration, there is another aspect of concentration of oil resources. Looking at the position of each of these countries it was observed that there is a wide disparity among the six Gulf Countries as far as their land-size and oil resources are concerned. Table IV shows the distribution of land area, GDP and oil export. As far as the land area is concerned, there is an extreme disparity. The single-largest country, Saudi Arabia accounts for as much as 84.7% of the block's total land area. The second largest, Oman, accounts for 11.3%. The remaining four countries hold a fractional part of the land, UAE 2.9%, Kuwait 0.7% Qatar 0.43% and Bahrain 0.03%. Thus, the smallest four states together hold less than 4% of the area.

TABLE IV
ARAB GULF STATES: UTILIZATION OF OIL AND GAS RESOURCES, 1980 [14]

	Oil			Natural	Gas
	Proven Reserves (Millions of Barrels	Production (thousands of barrel/day	Exports (thousands of barrels/day)	Proven resources (billions of cubic meters)	Production (millions of cubic meters)
Kuwait	67930	1663.7	1296.5	940.2	8780
Qatar	3585	471.4	465.7	1699.2	6400
KSA	168030	9900.5	9223.2	3183.2	53265
UAE	30410	1701.9	1697.3	616.7	17459
Oman	2340	281	278.1	70.8	NA
Bahrain	226	48.2	250.0	257.8	3715
Arab Gulf	272521	14066.7	12960.8	6767.9	89619
OPEC	435935	26878.4	22890.3	28566.9	275012
World	650104.7	59740.7	29857.0	75062.2	1581036
OPEC/World (%)	67.1	45.0	76.7	38.1	17.3
Arab Gulf /Opec (%)	62.5	52.3	56.6	23.7	32.8
Arab Gulf/ World (%)	42.0	23.5	43.4	9.0	5.7

A Framework for Cooperation United Nations Industrial Development Organization (UNIDO) 1983 assesses the impacts of oil resources on Arab Gulf Development [5]. United Nations Economic Commission for Western Asia (ECWA) Beirot 1980 [5] finds that the size disability is completely submerged. These small four countries UAE, Qatar, Kuwit and Bahrain just hold as small as 4% of the land hold relatively a very high share of the regional GDP. Their share in the regional GDP is 31.8%. This is so mainly because of higher concentration in GDP in the four countries. The country of Oman which has relatively larger land (11.3) has only 3.1% of the regional GDP. Saudi Arabia position is also redressed in terms of its share in regional GDP. With 85% of the land, it accounts for only 65% of the regional GDP. A similar trend is also observed in the distribution of total oil export. Out of these only two countries, UAE and Kuwait account for 22.6% of the regional export. The two largest countries comparatively have a stable relation of oil export with GDP. Saudi Arabia with 65% of the regional GDP, has 69.8% of the oil export, while Oman with 3.1% of the regional GDP, and has 2.1% of the oil export. The inconsistency in land-size distribution and GDP-oil export distribution should be taken as a special feature of the region. The economic disparities neutralized the trend towards regional cooperation. This was the experience of the Lafta and West African Community. Considering the land-size alone as the indicator of resource endowment will get a distorted picture of the economic disparities among the nations. Though size wise, there is a wide disparity, the oil resource-wise disparity is not that wide. Therefore, oil is a strong unifying bond of these countries. In this region though there is a size disparity it is moderated by an opposite resource disparity.

VII. EXPORT SURPLUS ECONOMIES

Usually the oil exporting countries are taken as export surplus countries having no problem of balance of payment. This is only one side of the story. It is true that in the six Gulf Countries of this region, in the decade ending 1981, the export surpluses amounted to $ US 74.4 billion, or about 35%, of their total GDP (Table V). This is both an opportunity as well as a challenge. It is an opportunity as these countries can proceed rapidly in their march on the way of economic development with these surpluses. But it is really a challenge to invest these resources in countries which have limited absorptive capacity. To overcome this limited domestic absorptive capacity, these countries embark on planning of agricultural development, improved economic infrastructure and investment in new industrial plants, etc. However, as per the 1981 figure, they could absorb only equivalent of 24.5% of the combined gross domestic product. In this net capital formation, Saudi Arabia's share was 70%, followed by UAE 16% and Kuwait 8%. Indeed, the winds of economic development have already touched these lands. However, the challenge is that, this investment will not continue endlessly. Unlike the export surpluses of other countries, these countries face a dilemma between increased production of exhaustible oil resources and increased investment to replace the depleted oil resources. This is the special problem of these countries which are no doubt export surplus economic but utilizing rapidly their exhaustible resources. This is directly relevant to regional cooperation. Indeed, the regional cooperation movement in this area is recognition of the gravity and urgency of this dilemma.

TABLE V
BASIC DISTRIBUTION OF LAND, GDP AND OIL EXPORT OF THE AREA GULF STATES [15]

	Bahrain	Kuwait	Oman	Qatar	KSA	UAE
Area (Square Kilometers)	669	17818	300000	11400	2250600	77700
In percentage	0.03	0.7	11.3	0.43	84.7	2.9
GDP	4113	25212	6577	6294	137554	31621
In percentage	1.9	11.9	3.1	3.0	65	15
Oil Export (in Volume)	1.9	9.8	2.1	3.5	69.8	12.8
Investment	1.1	7.8	3.1	2.1	69.8	16.1

VIII. ORGANIZATION OF THE OIL SECTOR

The single commodity dominance of the oil export has given rise to another distinctive feature in the economies of the Gulf Countries. The distinctive feature and distribution of oil and natural gases and the ownership of the natural and mineral resources and establishments rested with the government even before independence. This was the legal position but in practice foreign oil monopolies had full control on production and distribution under the agreement which provided fixed royalties to the government. These modest royalties left little revenue compared with the earnings of those companies. This situation implies a concerned transfer mechanism to take surpluses from the Gulf Countries to the foreign countries. This exploitative situation has to change and the GCC Countries took partial or complete stock holdings in oil companies operating in their territories. This virtually means a creation of a government monopoly or a national oil sector which not only owns but also actually controls the policies of production, distribution and pricing of oil. The national oil sector gave the governments of these countries an automatic control over the commanding heights of the economy. Thus, these countries had a positive advantage in the form of a government control over the largest and well-organized modern sector of the economy. This direct government control over the commanding oil sector gives a positive advantage to these countries. In the planning of economic development of the third world countries, the government had to play the spear-heading role but the existence of separate segregated and unorganized sectors acts as a serious obstacle to such a role. The Gulf Countries however, are better organized to allow the Government to play this developmental role. The oil sector is not the most organized sector but also the most modern sector of the economy. It is organized on modern lines by using the modern technology of exploitation, extraction and manufacture of oil and gas. Along with this, the organization has also adopted modern methods of marketing and management. A parallel development is the organization of an advanced financial and banking system. All these features of the oil sector have produced a structural dualism in the Gulf economies. There is a modern sector co-existing with a traditional sector in agriculture, small manufacturing and trading. The interdependence of these two sectors can be better organized because the modern sector is fully controlled by the government which has a welfare and developmental commitment towards the traditional sector. The dualism between the modern and traditional sectors poses serious problem in the developing countries as the whole process of development is biased in favor of the modern sector. To some extent at least, the Gulf Countries are in a better position to moderate this bias as the Government is in full control of the modern oil sector.

IX. CONCLUSION

The oil prices fall down will be effected by:

- Economic growth: The oil demanded will return back and the crude oil prices will fall down to lowest prices with budgets reached to crises and face difficulty to face their financial needs. Decrease in the prices will lead to lower their rate of economic growth and inability of their income and consumption.
- Credits and share markets: The lowest price share will lead to the increase their capital costs for company which looks for increasing their capital through their general issuing and the same time the profitability on loan and bond will lead to increases their financial cost, which makes the determination of commercial activities for companies and make use of the new chances investments.
- State loans and control: It confirms that the banks review their working loans for what they have done during their past periods from one side and on the other side keep their eyes open for any reasons to see the changes of price oil movements to control its systematic working. These developments may lead to the higher cost and brings these markets loan slowly for states which may share for stabilities in states markets in the region.

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