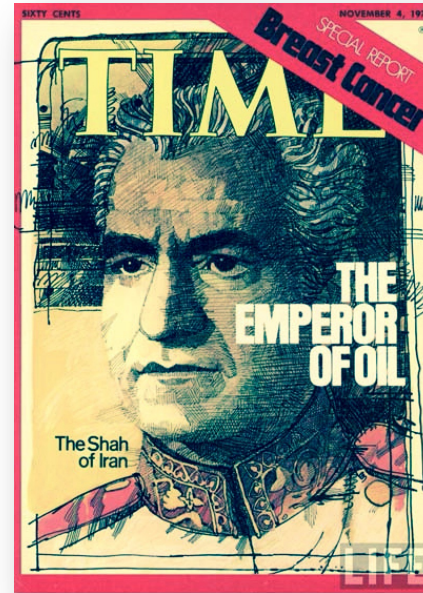


The political economy of petro-dollar recycling in Iran and Saudi Arabia in the 1970s



Ramin Nassehi (SOAS)

Fiscal balance (% of GDP)

	Iran	Saudi Arabia
1971	-5%	9%
1972	-9%	13%
1973	-3%	40%
1974	-3%	40%
1975	-5%	13%
1976	-3%	3%
1977	-6%	-2%
1978	-9%	-5%

Source: Salehi Esfahani & Taheripour (2002) and Niblock & Malik (2007).

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Fiscal vulnerability

Source: Salehi Esfahani & Taheripour (2002) and Niblock & Malik (2007).

Why Saudi Arabia saved a large portion of her petrodollars abroad after the 1973 oil boom while Iran spent almost all her petrodollars domestically?

Population difference?

	Oil revenues (1974)	Population (1974)
Iran	\$20 billion	32 million
Saudi Arabia	\$35 billion	7 million

Source: Amouzegar (2001).

Population difference?

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Population size  Lobbying

Population difference?

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Population difference?

	Oil revenues (1974)	Population (1974)	Oil revenues per capita
Iran	\$20 billion	32 million	\$625
Saudi Arabia	\$35 billion	7 million	\$5,000

Source: Amouzegar (2001).



Factors

Oil boom/population
Quality of institutions
Ideology

→ policies

1973

Time

Path-dependent process



1973

Time

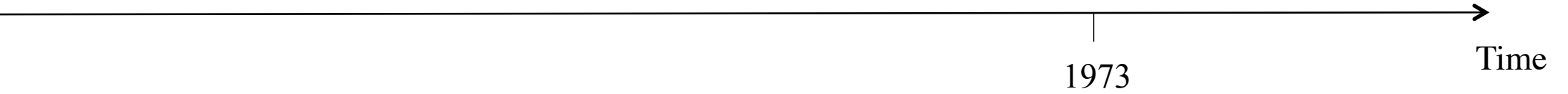
Path-dependent process

Decisions



policies

Self-reinforcing effects over time





Pattern of institutional and economic development

Decisions



policies

Early
1950s

1973

Time

Analytical narrative



Pattern of institutional and economic development

Decisions



policies

Early
1950s

1973

Time

Analytical narrative



1950 = Crucial moment



Political elite

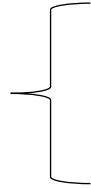
- Fragmented power structure
- Conservative ideology

1950 = Crucial moment



Political elite

- Fragmented power structure
- Conservative ideology



1950 = Crucial moment



Political elite

- Fragmented power structure
- Conservative ideology

Patrimonial and divided bureaucracy (No planning agency)

1950 = Crucial moment



Political elite

- Fragmented power structure
- Conservative ideology

Patrimonial and divided bureaucracy (No planning agency)

Infrastructure building (no diversification strategy)

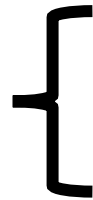
1950s

Steady rise



Political elite

- Fragmented power structure
- Conservative ideology



Patrimonial and divided bureaucracy (No planning agency)

Infrastructure building (no diversification strategy)

1950s & 1960s

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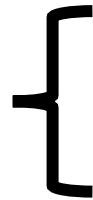
1950s & 1960s

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Political elite

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Patrimonial and divided bureaucracy (No planning agency)

Infrastructure building (no diversification strategy)



Economic growth (
Low inflation (2%)

1950s & 1960s

Steady rise



Political elite



Patrimonial and divided bureaucracy (No planning agency)

Infrastructure building (no diversification strategy)



Economic growth ()
Low inflation (2%)

-Fragmented power structure
-Conservative ideology



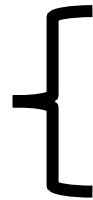
Positive Feedback

1950s & 1960s

Steady rise



Political elite



Patrimonial and divided bureaucracy (No planning agency)

Infrastructure building (no diversification strategy)



Economic growth ()
Low inflation (2%)

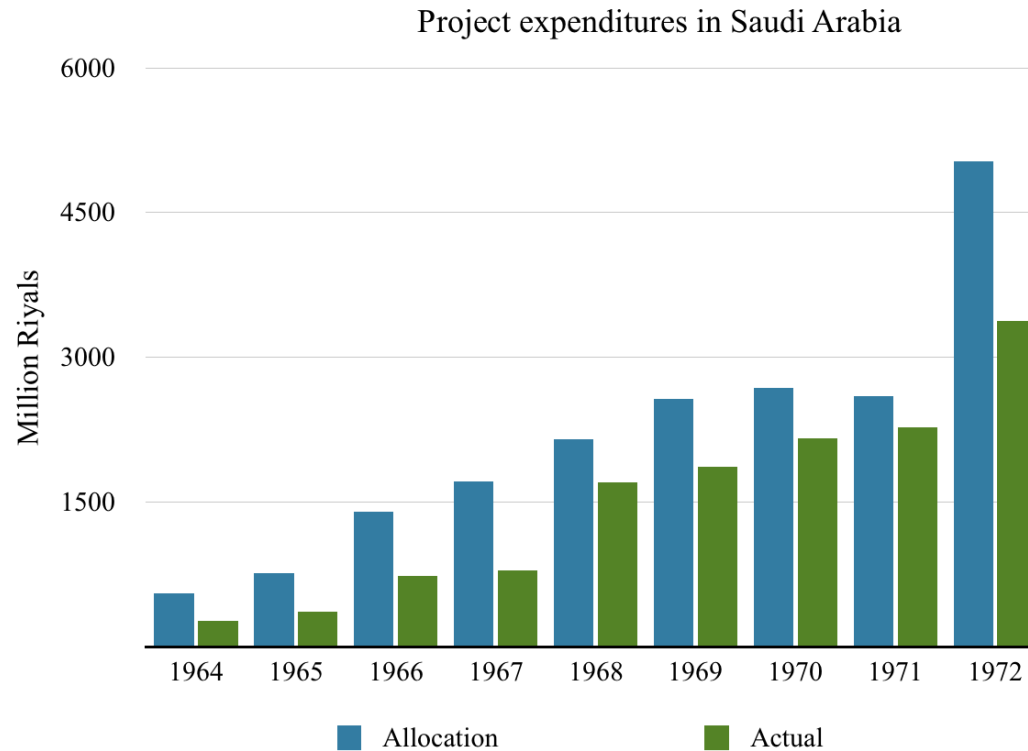
-Fragmented power structure
-Conservative ideology

Two problems!



Positive Feedback

1. Low institutional capacity for development spending



Source: SAMA Annual Report (1973, 1972, 1964)

2. Highly undiversified economy (low capacity for absorbing investment)

Saudi Arabia: Structure of GDP in 1972

Agriculture	4.6%
Oil	54.1%
Manufacturing & mining	2.2%
Services	39.1%

Source: IBRD (1974) and Moliver & Abbondante (1980)

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The elite were already wary of the “limited absorptive capacity” of their bureaucracy and economy

1973 oil boom



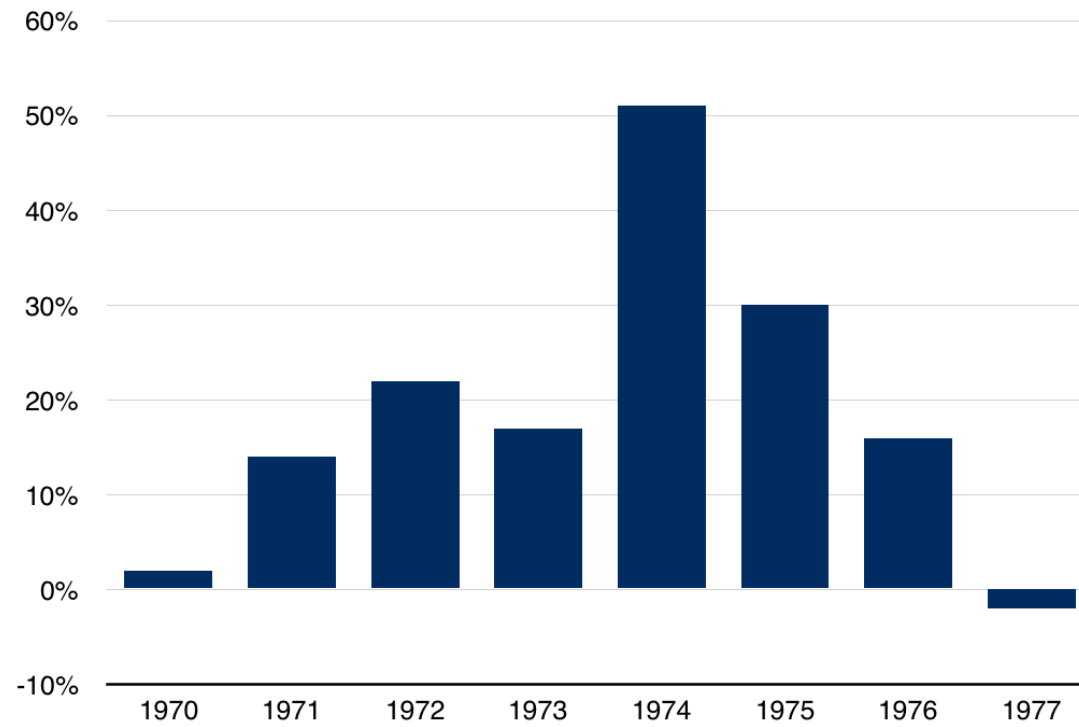
Political elite

- Fragmented power structure
- Conservative ideology

Patrimonial and divided bureaucracy

petrodollar savings

Saudi Arabia: Current Account Balance (% of GDP)



Source: SAMA (1978), Niblock & Malik (2007).

1973 oil boom



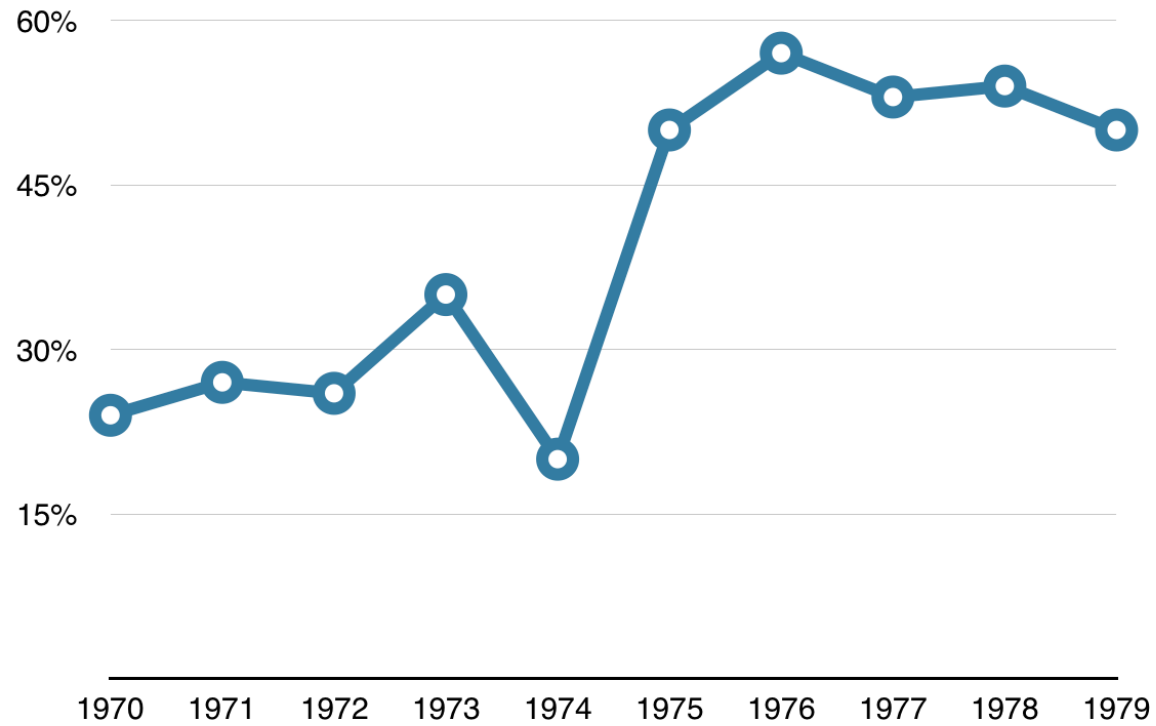
Political elite

- Fragmented power structure
- Conservative ideology

Patrimonial and divided bureaucracy

petrodollar savings + significant increase in domestic spending

Fiscal spending in Saudi Arabia (% of GDP)



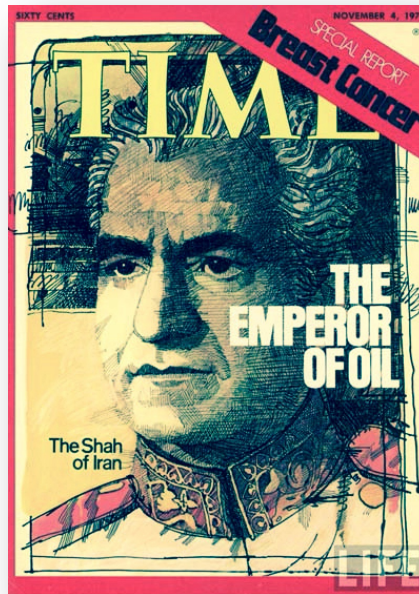
Source: Niblock and Malik (2007)

Summary: Due to its previous pattern of institutional and economic development, Saudi Arabia had a weak public bureaucracy and an undiversified economy at the time of the 1973 oil boom.

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So the elite were *already wary* of the “limited absorptive capacity” of their bureaucracy and economy. Thus, they knew that they had *no option* but to save a large part of their petrodollars abroad.

Analytical narrative



1954 = Crucial moment



Political elite

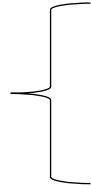
- Centralised power structure
- Developmentalist ideology

1954 = Crucial moment



Political elite

- Centralised power structure
- Developmentalist ideology



1954 = Crucial moment



Political elite

- Centralised power structure
- Developmentalist ideology

Cohesive and technocratic bureaucracy

1954 = Crucial moment



Political elite

- Centralised power structure
- Developmentalist ideology

Cohesive and technocratic bureaucracy

Economic diversification strategy

1950s & 1960s

Steady rise



Political elite

- Centralised power structure
- Developmentalist ideology

Cohesive and technocratic bureaucracy

Economic diversification strategy

1950s & 1960s

Steady rise



Political elite

- Centralised power structure
- Developmentalist ideology

Cohesive and technocratic bureaucracy
Economic diversification strategy



Economic growth
Structural change

1950s & 1960s

Steady rise



Political elite

- Centralised power structure
- Developmentalist ideology

- Cohesive and technocratic bureaucracy
- Economic diversification strategy



Economic growth
Structural change



Positive Feedback

1. Well-developed public bureaucracy

1. Well-developed public bureaucracy

2. Relatively diversified economy

Iran: Structure of GDP in 1972

Agriculture	14.7%
Oil	27.4%
Manufacturing & mining	14.4%
Services	43.5%

Source: IBRD (1974).

1. Well-developed public bureaucracy

2. Relatively diversified economy

Iran: Structure of GDP in 1972

Agriculture	14.7%
Oil	27.4%
Manufacturing & mining	14.4%
Services	43.5%

Source: IBRD (1974).

The Shah was *NOT* wary of the “limited absorptive capacity” of his bureaucracy and economy

Summary: Due to its previous pattern of institutional and economic development, Iran had a well-developed public bureaucracy and a diversified economy at the time of the 1973 oil boom.

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So the Shah was *not wary* of the “limited absorptive capacity” of his bureaucracy and economy. As a result, he decided to spend all the proceeding oil revenues domestically.

Conclusions

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- The different fiscal responses of Saudi Arabia and Iran to the 1973 oil shock were shaped by their contrasting pattern of institutional and economic development since the early 1950s.
- Past experiences and learning matter!
- Petro-states exhibit path-dependent behavior: decisions made at “crucial moments” can shape their future trajectory.