timum tariff case was the only case of international policy conflict considered. Therefore, economists have analyzed international prisoner's dilemma problems infrequently and mainly in the context of tariff protection.[98] It will be much more difficult to find theoretical and practical solutions for the more complex situations arising with multidimensional nontariff interventionism.[99] For both tasks, the economics profession will have to borrow from the experience of related disciplines, and economists will have to pay more attention to institutional details affecting practical policy choices.[100] Furthermore, it will be necessary to recognize differences in size and interests of major and minor players that affect their roles in international economic rivalry and cooperation.[101]

98. Johnson, "Optimum Tariffs and Retaliation"; Wolfgang Mayer, "Theoretical Considerations on Negotiated Tariff Adjustments," *Oxford Economic Papers* 33 (March 1981), pp. 135–53; Marie Thursby and Richard Jensen, "A Conjectural Variation Approach to Strategic Tariff Equilibria," *Journal of International Economics* 14 (February 1983), pp. 145–61; and John Whalley, *Trade Liberalization Among Major World Trading Areas* (Cambridge, Mass.: MIT Press, 1985).

99. Richardson, "New Political Economy of Trade Policy"; and Dixit, "How Should the United States Respond?"

100. A combination of economics and political science has been used successfully in research on U.S. trade policy, such as in Baldwin, *Political Economy of U.S. Import Policy;* and Destler, *American Trade Politics: System Under Stress*. Computer simulation work of the "prisoner's dilemma" by Robert Axelrod, a political scientist, has greatly stimulated the discussion of international economic policies by economists. Robert Axelrod, *The Evolution of Cooperation* (New York: Basic Books, 1984). This work is favorably reviewed by several of the authors cited above, including Brander, "Rationales for Strategic Trade and Industrial Policy," pp. 39–43; Richardson, "New Political Economy of Trade Policy," pp. 270–74; Brander, "Shaping Comparative Advantage," pp. 23–27; Deardorff and Stern, "Current Issues in Trade Policy," pp. 55–56; and Dixit, "How Should the United States Respond?" pp. 278–79. For an early adaptation of Axelrod's work to trade policy, see Judith L. Goldstein and Stephen D. Krasner, "Unfair Trade Practices: The Case for a Differentiated Response," *American Economic Review* 74 (May 1984), pp. 282–87.

101. An innovative approach to this problem that combines the theory of "hegemonic stability" and the concept of "transactions cost economics" has been proposed by Beth V. Yarbrough and Robert M. Yarbrough, "Cooperation in the Liberalization of International Trade: After Hegemony, What?" *International Organization* 41 (Winter 1987), pp. 1–26. See also Susan Strange, "The Persistent Myth of Lost Hegemony," *International Organization* 41 (Autumn 1987), pp. 551–74. John A. C. Conybeare, *Trade Wars: The Theory and Practice of International Commercial Rivalry* (New York: Columbia University Press, 1987) very much focuses on the relative size of players in his explanation of trade wars. Conybeare's study is highly recommended because it adds methodological and historical perspectives to the debate on economic models of strategic trade policy.

XP TO V1T

The price of wealth: business and state in labor remittance and oil economies

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XP 120065

Introduction

Although the effects of capital inflows on developing countries have been the focus of intense and unresolved controversy among historians, political scientists, and economists, the most extreme cases of dependence on external capital remain the least explored. The inflow of capital into oil-rich countries in the 1970s and 1980s and the resulting flow of remittances to labor exporters constitute the most dramatic examples of transborder capital movement in modern times, comparable only to the influx of American bullion into sixteenth-century Spain.[1] This article contrasts the effects of these two types of external capital flows on institutional development, state

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1. To contrast different opinions on the relationship between bullion and the decline of Spain, see Perry Anderson, *Lineages of the Absolutist State* (London: Verso Press, 1984), pp. 60–84; Immanuel Wallerstein, *The Modern World System* (New York: Academic Press, 1974); Fernand Braudel, *The Mediterranean and the Mediterranean World in the Age of Philip II* (New York: Harper & Row, 1973), vol. 1, pp. 418–541, and vol. 2, pp. 661–733; John Eliott, "The Decline of Spain," *Past and Present* 20 (November 1961), pp. 52–75; Henry Kamen, "The Decline of Spain: A Historical Myth?" *Past and Present* 81 (November 1978), pp. 24–50; J. E. Eliott, *Imperial Spain, 1469–1716* (London: Pelican Press, 1963); and A. W. Lovett, *Early Habsburg Spain, 1517–1598* (London: Oxford University Press, 1986). Different perspectives are summarized succinctly in Pierre Vilar, *A History of Gold and Money, 1450–1920*, 2d ed. (London: Verso Press, 1984), pp. 102–68.

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structure and capacity, national integration, and business-government relations in the Yemen Arab Republic and Saudi Arabia.[2]

Widespread cynicism concerning the validity of dependency theory has generated renewed efforts to chart the effects of different types of capital inflows on developing countries, opening up new areas of comparative inquiry. While recent studies hint at the importance of differentiating between different types of capital flows to developing countries, few explicitly comparative analyses have emerged from the ferment. The study of oil rents and labor remittances, the dominant forms of capital inflows in the modern Middle East, remains the preserve of area specialists, who tend to prefer single, highly descriptive case studies.[3] Privately controlled revenues have received almost no attention, and systematic comparisons of the effects of publicly and privately controlled capital inflows are virtually nonexistent.[4] Focusing on extreme cases of dependence on two very different types of external capital, this comparative study demonstrates that the *type, volume,* and *control* of different kinds of capital inflows decisively influence the ability of state bureaucracies to respond to economic crises.[5]

2. I define "institutional development" as the penetration of forms of authority that might challenge the existence of the state and the expansion and centralization of the fiscal, legal, and regulatory instruments of the state. Beyond this, I accept Samuel P. Huntington's measures of "adaptability, complexity, autonomy, and coherence" as presented in *Political Order in Changing Societies* (New Haven, Conn.: Yale University Press, 1968), pp. 8–32. "Institutional structure" is defined as the differential development of coercive, extractive, distributive, redistributive, regulatory, and participatory institutions. "State capacity" is measured by the ability of the government to formulate and implement policies and includes an institutional and a political component. By "national integration" I mean the use of resources, incentives, force, and assimilation to temper the importance of regional, ethnic, and sectarian cleavages that might threaten national integrity.

3. Broader efforts to study the "state in the Middle East" or "Africa" tend to use geography as a substitute for methodology. What might be called the theoretical work produced by Middle East area specialists either tends towards cultural explanations or attempts to set research agendas. An example of the former tendency is Elia Zureik's "Theoretical Considerations for a Sociological Study of the Arab State," *Arab Studies Quarterly* 3 (Autumn 1981), pp. 229–57. An example of the latter is Lisa Anderson's survey of work in progress, "The State in the Middle East and North Africa," *Comparative Politics* 20 (Fall 1987), pp. 1–18, in which it is argued that the Middle East ought to be "brought back in."

4. Exceptions are Peter Evans, "Transnational Linkages and the Economic Role of the State: An Analysis of Developing and Industrialized Nations in the Post–World War II Period," in Peter Evans, Dietrich Reuschemeyer, and Theda Skocpol, eds., *Bringing the State Back In* (New York: Cambridge University Press, 1985), pp. 192–225; Everet Hagen, *The Economics of Development* (Homewood, Ill.: Richard D. Irwin, 1975); and Voker Bornschier et al., "Cross-national Evidence on the Effects of Foreign Investment and Aid," *American Journal of Sociology* 86 (November 1978), pp. 651–83. The literature on "Dutch disease" outlines common tendencies in economies that are recipients of windfall profits. For an excellent review of the literature, see W. M. Corden, "Booming Sector and Dutch Disease Economics: Survey and Consolidation," *Oxford Economic Papers* 36 (November 1984), pp. 359–80. For a comparative analysis of oil exporters, see Alan Gelb, "Adjustment to Windfall Gains: A Comparative Analysis of Oil Exporting Countries," Development Research Department, World Bank, Washington, D.C., October 1984.

5. Development aid, borrowing on the international market, labor remittances, oil rent, direct foreign investment, and revenues from foreign purchases of government bonds and equity are all examples of exogenous capital, although remittances, oil revenues, and equity and bond investments are usually not included in taxonomies.

The structure and functions of state institutions in both Saudi Arabia and Yemen were transformed by the capital inflows of the prosperous 1970s. In both cases, high levels of external capital inflows coincided with the initial stages of state-building, creating a disjuncture between the development of regulatory, extractive, and distributive state institutions. Oil rents created a huge, financially autonomous distributive bureaucracy in Saudi Arabia. Labor remittances in Yemen totally bypassed both state institutions and the formal banking system. Remittances engendered an independent and affluent private sector but also provided opportunities for the government to tap remitted funds indirectly through import duties. Both bureaucracies grew, albeit at different rates. Yet, amid this apparent burst of state-building, the most essential function of the modern state, its power to tax, declined. In both states, extractive institutions and their ancillary legal, fiscal, and information-gathering bureaucracies atrophied.

Apart from this similarity, oil revenues and labor remittances had divergent and unexpected effects on business-government relations and state capacity. These differences came to the fore when oil prices fell in 1983–84, precipitating a fiscal crisis in both countries. Here the political responses of the bureaucracies diverged sharply: while the Saudi government was unable to replace external capital with domestic revenue, the Yemeni government instituted a thoroughgoing reform package, including heavy and retroactive taxation.

Why did the Saudi state, superficially the stronger, fail, where the Yemeni state, apparently the weaker, succeeded? The answer lies in the divergent patterns of social change sparked by two different forms of capital inflow in deeply divided societies engaged in the initial stages of state-building. In both cases, external capital inflows reinforced existing primordial cleavages, but with radically different implications for business-government relations. Oil rents were transmitted directly to the centralized organs of the Saudi state, which then distributed them through contracts, gifts, interest-free loans, and subsidies. During the boom years, these distributive policies created a new private sector that mirrored the tribal and regional composition of the bureaucracy, linking business and government through kinship networks, tribal loyalties, and business partnerships. During the recession, these primordial ties at once obscured the conflicting interests of business and the state and provided an effective informal framework for opposing austerity measures. Labor remittances, by contrast, accrued directly to millions of Yemeni migrants through an informal, decentralized banking system that fed the buoyant private sector with virtually unlimited amounts of foreign exchange. Unlike oil revenues, labor remittances concentrated economic opportunity in the private sector, where the traditional southern Suni merchant class not only maintained its dominance but expanded dramatically as migrants from the south entered the lower echelons of the business community. The northern Shia tribal areas, which were not centers for labor

export, continued to staff the army and the bureaucracy. Labor remittances accentuated longstanding disequilibria in the social composition of the bureaucracy and army on the one hand and the merchant class on the other by adding a stark economic dimension to cleavages that already sliced along occupational, sectarian, and regional lines. The Yemeni bureaucracy, lacking the financial means to create a system of distribution under conditions of wide-based prosperity, actually augmented its political and social independence from the private sector. During the boom years, remittances so divided the interests of business and the state that when the crisis came to Yemen, state bureaucrats were able to override the objection of private businessmen and create new instruments of extraction, regulation, and state monopoly.

Paradoxically, in neither case did massive resources augment the efficacy of those that controlled them: the financial autonomy of the Saudi state did not translate into the ability to implement economic reform in times of crisis, nor did the financial independence of the Yemeni private sector enhance its ability to resist such economic reforms. These findings are counterintuitive. They challenge conventional views on the relationship between capital abundance and institutional entrenchment, state autonomy and state strength, independence and efficacy. The cases underscore the importance of viewing different types of external capital as distinct independent variables that directly influence business-government relations and state capacity. Further, the unequal effects of external capital inflows on different clusters of state institutions underscore the importance of disaggregating the "state" as a dependent variable. By using the examples of two developing countries engaged in the initial process of state-building and national integration, this analysis highlights the importance of social context in assessing the domestic impact of international economic forces.

The discussion begins by situating oil revenues and labor remittances within an analytical typology of external capital inflows and is followed by a critique of widely accepted views on state and group autonomy. The case material is divided into three parts: the first section places the cases in historical context; the second covers the period between 1973 and 1983 and focuses on changes in institutional structure and business-government relations in the economic boom; and the third covers the years between 1983 and 1987, when a decline in external capital inflows precipitated a severe recession that placed new demands on the state and tested the strength of boom-time coalitions.[6] The "boom" pattern stresses the institutional and political relationships that emerge in response to external capital inflows, while the "bust" pattern demonstrates how institutional and political relationships forged during the boom years break down in times of crisis, conditioning policy outcomes in unexpected ways.

6. The special utility of studying politics in times of economic crisis is eloquently presented in Peter Gourevitch, *Politics in Hard Times* (Ithaca, N.Y.: Cornell University Press, 1986).

TABLE 1. *Typology of international capital inflows*

Type of inflow	*Degree of state control*	*Transnational "third actor"*	*Types of external pressure*
Oil revenues.	High (very centralized).	None.	Market shocks (highly volatile).
Development aid, sovereign borrowing, private borrowing, and direct foreign investment.	Mixed (relatively centralized).	Donors, syndicates, international banks, multinational corporations, IMF, World Bank, and so forth.	Periodic review, negotation, bargaining, pressure for reform, and political concessions.
Labor remittances.	Low (widely dispersed).	None.	Market shocks (highly volatile).

Situating the cases: varieties of capital inflows

While the phenomenon of massive capital movements across borders is not a new one, different varieties of international transfers have increased in the post–World War II era. Perhaps owing to this diversity, analytically important distinctions between the different types of capital inflows and the systematic effects of intervening variables, such as levels of bureaucratic and entrepreneurial development in mediating the effects of inflows, remain obscured. Oil revenues and labor remittances are not even included in existing taxonomies of international capital flows. Comparative studies of effects of external capital inflows might usefully be informed by the following four distinctions.

The first and primary distinction between different types of capital inflows involves variations in the *degree of control* that different public or private sector groups have over their allocation and the extent to which that control is dispersed or centralized (see Table 1). Labor remittances accrue directly to millions of migrants, often tenant farmers or landless peasants, through informal, decentralized, and unregulated banking systems that are invulnerable to state control.[7] At the opposite end of the spectrum, oil rents and

7. Placing recipients of labor remittances in a single category is difficult, since labor-exporting countries usually receive some form of developmental aid or borrow on the international market. But for Egypt, Yemen, Pakistan, India, Jordan, Tunisia, Turkey, Sudan, Somalia, and others

revenues from government bond sales to foreigners are highly centralized. They are transmitted directly to the state, which then distributes them through various mechanisms. Other forms of external capital, such as development aid, borrowing, and direct foreign investment, fall somewhere in between, apportioning control among government decision-makers, transnational actors, and domestic entrepreneurs.[8]

The second distinction is between capital inflows that involve a transnational "third actor," in the form of multinational corporations, donors, or lending institutions, and those that are regulated exclusively by international market forces. Oil revenues, labor remittances, and bond or equity sales to foreigners are highly volatile, while aid, direct foreign investment, and borrowing tend to be more stable and are subject to periodic review and negotiation between domestic and international actors. Market-regulated capital inflows elicit different institutional responses from those involving a transnational actor: the administrative problems of dealing with a distinct set of transnational actors require institutions that are qualitatively different than those prompted by the vicissitudes of the international market. Aid, foreign investment, and international borrowing are types of capital that favor a large state role in negotiating, administering, and allocating resources—particularly in integrated nation-states that have strong, entrenched bureaucracies confronting a definable set of transnational actors. Further, where no "third actor" exists, the possibility of alliances between transnational actors and the domestic interests is obviated, thereby conditioning the strength of coalitions that might form in reaction to disruptive state policies. Thus, although remittances and oil revenues are connected to volatile forces in the international economy, foreign institutions have relatively little direct influence over domestic economic policy, thereby negating key assumptions of dependency theory. In all, oil and labor remittance cases are an ideal ground for testing the effects of market-regulated capital inflows on domestic conditions.

The third distinction is that cases vary according to their *level of dependence* on foreign capital. The absolute level of global capital flows and the number of recipients have grown with time, but extreme cases form an analytically distinct category. In Israel, Saudi Arabia, the Yemen Arab Republic, Kuwait, the United Arab Emirates, Libya, and Iraq, international capital inflows constitute 50 percent or more of the gross national product (GNP). By comparison, the reliance of newly industrialized countries is mild: on average, in 1980, their cumulative disbursed foreign debt was about 25 percent of their 1980 GNP and constituted only 40 percent of investment capital for that year.[9]

The fourth distinction involves the preexisting *strength of regulatory institutions and entrepreneurial groups*. This is an important *intervening* variable in determining the state's ability to allocate resources in the service of developing coherent economic policies and promoting national integration. Degrees of bureaucratic and entrepreneurial development were crucial in determining the success or failure of European colonial powers to take advantage of external capital inflows and overseas markets in the eighteenth and nineteenth centuries.[10] The experience of modern recipients is similar. If even advanced industrial states find it difficult to moderate the effects of highly mobile international capital,[11] countries with undifferentiated governmental apparatuses are likely to evolve almost solely on the basis of capital inflows, generating bureaucracies that are direct products of the international economy. Where capital inflows coincide with the birth of the bureaucracy, institutions are especially vulnerable to fluctuations in the international market and must overcome both institutional obsolescence and domestic opposition in times of economic recession.

When situated on these spectrums, Saudi Arabia and the Yemen Arab Republic are similar in all respects but one. Apart from the temporary effects of the Organization of Petroleum Exporting Countries (OPEC), both oil and labor remittances are regulated only by exceptionally volatile international market forces rather than by transnational actors. Both Yemen and Saudi Arabia are tribal societies divided along sectarian and regional cleavages. Neither country has been troubled by the experience of formal representative government, and both embrace capitalist economic principles. Both countries were at a primitive stage of state-building and national integration at

labor export is the largest foreign exchange earner. In countries with strong regulatory institutions, remittances can be controlled through management. In South Korea, for example, remittances are harnessed by providing preferential investment opportunities to labor in exchange for foreign currency earnings and through integrating labor export with Korean contractors in the Middle East. See Sooyong Kim, "Contract Migration in the Republic of Korea," International Labor Organization (ILO) Working Paper, Geneva, International Migration for Employment Branch, 1982; and *Overseas Employment Administration in Selected Asian Countries*, Proceedings of the ILO and Asian and Pacific Project for Labour Administration (ARPLA) Inter-Country Symposium on Overseas Employment Administration, Pattaya, Thailand, May 1984.

8. Jeff Freiden estimates that 80 to 90 percent of international lending among the largest debtor nations was to the public sector or the central banks. See Jeff Freiden, "Third World Indebted Industrialization: International Finance and State Capitalism in Mexico, Brazil, Argentina, and South Korea," *International Organization* 35 (Winter 1981), p. 441.

9. International Bank for Reconstruction and Development, *World Tables*, various years.

10. The relationship between capital inflows and the Industrial Revolution has been explored in Patrick O'Brien, "European Economic Development: The Contribution of the Periphery," *Economic History Review*, 2d. ser., 35 (Fall 1982), pp. 1–18; David Landes, *The Unbound Prometheus: Technological Change and Industrial Development in Western Europe from 1750 to the Present* (London: Cambridge University Press, 1967); and Immanuel Wallerstein, *The Modern World System*, 2d. ed. (New York: Academic Press, 1980), pp. 164–345.

11. With the exception of Japan, foreign capital inflows have played a major role in the economic development of every industrialized country. See Henry Rosovsky, "What Are the 'Lessons' of Japanese Economic History?" in A. J. Youngson, ed., *Economic Development in the Long Run* (New York: St. Martin's Press, 1973); and David Landes, "Japan and Europe: Contrasts in Industrialization," in William Lockwood, ed., *The State and Economic Enterprise in Japan* (Princeton, N.J.: Princeton University Press, 1965), pp. 93–182.

the onset of capital inflows. Neither country has had a long history of bureaucratic development or been colonized for any significant period of time. In both cases, levels of reliance are exceptionally high: since 1973, oil rent and labor remittances have constituted well over 80 percent of the Saudi and Yemeni GNP. Yet oil revenues and labor remittances differ in one crucial feature: Saudi oil rent is controlled exclusively by the state, while Yemeni labor remittances are controlled by the private sector.

Effects of capital inflows: state and group autonomy in primordial societies

Early research on aid and foreign investment posited direct links between the international economy and economic change in developing countries, prompting the familiar observation that traditional dependency formulations obscure the independent role of the state as a mediator between domestic and foreign capital. Even when they disagreed on the ultimate costs and benefits of "dependence," early studies of the effects of aid and foreign investment on income distribution, domestic investment patterns, regime type, and consumption patterns led liberal and leftist theorists to concur that the state in developing countries was hostage to the machinations of powerful donors, multinational corporations, and international lending agencies.[12] The emphasis of dependency and world systems analysts was on the extraction of precious resources from the periphery rather than on the transfer of capital to the developing world. Thus, on balance, dependence on foreign capital as an indicator of underdevelopment received much more attention than the actual effects of foreign capital on the relationship between the state and domestic actors or classes.[13]

More recent work consciously separates state actors and local capitalists,[14] illustrating three ways in which the economic role of host governments might be expanded by contact with foreign donors, investors, and lenders. First, as the allocator and underwriter of international loans, the state augments its financial autonomy and increases its role in the local economy by controlling domestic credit.[15] Second, the state's efforts to control multinational corporations might fashion administrative capacities that buttress its domestic strength, eventually enabling it to supervise or supplant the managerial role of the multinational.[16] Finally, the state may exert more control by performing the role of broker between domestic and foreign capital.[17] In line with these findings, it has been argued that external dependence need not be positively correlated with diminishing state capacities or internal weakness: under certain circumstances, the inverse might be true.[18] Similarly, access to international finance and links to the international economy may enhance the independence and efficacy of private-sector elites in developing countries.[19]

Cases like Libya, Saudi Arabia, the United Arab Emirates, and Iraq are the most obvious test cases for the hypothesis that state-controlled inter-

12. H. J. Bruton, "The Two-Gap Approach to Aid and Development: Comment," *American Economic Review* 59 (June 1969), pp. 439–46; Hollis Chennery and A. M. Strout, "Foreign Assistance and Economic Development," *American Economic Review* 56 (September 1966), pp. 680–733; K. Griffen, "The Effect of Aid and Other Resource Transfers on Savings and Growth in LDCs: A Comment," *Economic Journal* 83 (September 1973), pp. 863–66; P. T. Bauer, *Dissent on Development*, rev. ed. (Cambridge, Mass.: Harvard University Press, 1976); Richard Rubinson, "The World Economy and the Distribution of Income within States," *American Sociological Review* 41 (August 1976), pp. 638–59; Edward Muller, "Financial Dependence in the Capitalist World Economy and Distribution of Income within Nations," paper presented at the annual meeting of the American Political Science Association, 1983; Christopher Chase-Dunn, "The Effects of Internal Economic Dependence on Development and Inequality: A Cross-National Study," *American Sociological Review* 40 (December 1975), pp. 720–38; Theodore Moran, *Multinational Corporations and the Politics of Dependence: Copper in Chile* (Princeton, N.J.: Princeton University Press, 1974); Raymond Vernon, *Sovereignty at Bay: The Multinational Spread of U.S. Enterprises* (New York: Basic Books, 1971); James Kurth, "The Political Consequences of the Product Life Cycle," *International Organization* 33 (Winter 1979), pp. 1–34; and Harrison Wagner, "Dissolving the State: Three Recent Perspectives on International Relations," *International Organization* 28 (Summer 1974), pp. 435–66. Joel Migdal makes this argument in "The Study of Development and Underdevelopment: The State of the Art," in Ada Finifter, ed., *Political Science: The State of the Discipline* (Washington, D.C.: American Political Science Association, 1983).

13. The work of Raul Prebisch, Samir Amin, Fernando Cardoso and Enzo Faletto, and Arghiri Emmanuel exemplifies this literature. The numerous works of classical dependency theory need not be listed here, since reviews are found elsewhere. See Tony Smith, "The Underdevelopment of Development Literature: The Case of Dependency Theory," *World Politics* 31 (January 1979), pp. 247–88.

14. Peter Evans, "Reinventing the Bourgeoisie: State Entrepreneurship and Class Formation in Dependent Capitalist Development," in Michael Burawoy et al., eds., *Marxist Inquiries: Studies of Labor, Class and States* (Chicago: University of Chicago Press, 1982), pp. S210–47; David Becker, *The New Bourgeoisie and the Limits of Dependency: Mining, Class and Power in Revolutionary Peru* (Princeton, N.J.: Princeton University Press, 1983); and Michael Shafer, "Capturing the Multinationals: Advantage or Disadvantage?" in Theodore Moran, ed., *Multinational Corporations: The Political Economy of Foreign Direct Investment* (Lexington, Mass.: Lexington Books, 1985), pp. 25–54.

15. Stephan Haggard and Tun-Jen Cheng, "State and Foreign Capital in the East Asian NICs," in Fred Deyo, ed., *The Political Economy of the New Asian Industrialism* (Ithaca, N.Y.: Cornell University Press, 1987); Jeff Freiden, "Third World Indebted Industrialization"; and Richard Barrett and Martin King Whyte, "Dependency Theory and Taiwan: Analysis of a Deviant Case," *American Journal of Sociology* 87 (March 1982), pp. 1064–89.

16. Frank Tugwell, *The Politics of Oil in Venezuela* (Stanford, Calif.: Stanford University Press, 1975); and Peter Evans, "Recent Research on Multinational Corporations," *Annual Review of Sociology* 7 (1981), pp. 199–223.

17. Peter Evans, *Dependent Development: The Alliance of Multinational, State and Local Capital in Brazil* (Princeton, N.J.: Princeton University Press, 1979); John Boli Bennett, "Global Integration and the Universal Increase of State Dominance," in Albert Bergesen, ed., *Studies of the Modern World System* (New York: Academic Press, 1980), pp. 77–107; and Haggard and Cheng, "State and Foreign Capital."

18. Evans, "Transnational Linkages."

19. Peter Evans, *Dependent Development;* Fernando Cardoso and Enzo Faletto, *Dependence and Development in Latin America* (Berkeley: University of California Press, 1979); and Samir Amin, *The Arab Nation* (London: Zed Press, 1978).

national capital augments state strength, autonomy, and capacity. Major oil exporters are financially autonomous from their citizenry. Unlike welfare states, which are "redistributive," extracting and reallocating resources, rentier states[20] do not exist by extracting surplus from the local population.[21] Indeed, institutional development in distributive states is likely to diverge from classic patterns of state-building, since their bureaucracies emerged in response to the need to allocate rather than appropriate revenues.[22] Furthermore, class stratification in purely distributive states is likely to be an exclusive function of state spending patterns, representing an extreme form of corporatism in which the state not only reorganizes or promotes, encourages, or disbands existing occupational groups, but actually *creates* entire sectors through its distributive policies.[23] In comparison to major oil exporters, all other cases are rather mild examples of state "autonomy," since they rely on domestic surplus for at least some of their revenue.

In major labor exporters, among which Yemen is the most extreme example, the bulk of economic transactions take place in an informal market without state regulation or supervision. Through these markets, private-sector elites have access to virtually unlimited amounts of foreign exchange for investment, imports, and hoarding, which enable them to thrive without the protection, funding, and supervision associated with capitalism in late developers.[24] Apart from guaranteeing the financial independence of the private sector, remittances generate local resources that enable rural communities to suspend reliance on the state for the provision of basic infrastructure, such as roads, electricity, water, clinics, and schools.

With a single exception,[25] as an attribute of social groups or the state, "autonomy" has always been seen as a symptom of or a prerequisite for strength.[26] Unfettered by narrow class interests, "autonomous" states are deemed capable of making decisions that favor the long-range vision of technocrats over the short-term interests of "dominant" social groups. Even democratic regimes, we are told, wield the power to make policies based on an agenda set in the inkwells of the bureaucracy,[27] while authoritarian regimes suppress demands for participation and equity in the interest of capitalist development. Similarly, "autonomous" social groups spearhead revolutions, transforming the system by will[28] or circumstance.[29] In line with these widely accepted attributes of autonomy, we would expect private-sector elites in Yemen and the government of Saudi Arabia to exhibit the institutional and political characteristics outlined under "expected relationships" in Table 2. In Saudi Arabia, the financially autonomous state should have deployed its considerable resources to promote national integration and political acquiescence, while the private sector ought to be weak and dependent on government contracts and largess. In Yemen, we might expect the opposite: a weak and ineffective state, overshadowed by a strong, autonomous private sector and vibrant local participatory institutions.

The predicted effects of oil rent and remittances on the relative strength of the state and the private sector conformed to expected patterns during the boom period. The decline of extractive institutions in both cases and the rise of distributive institutions in Saudi Arabia were important unanticipated consequences of the inflows. However, during the "bust" period, empirical challenges to predicted outcomes and relationships emerge in full bloom. As Table 2 shows, policy outcomes in the crisis of the mid-1980s are the exact opposite of expectations. Three factors are of key importance in explaining these results: (1) the impact of the sectoral distribution of capital inflows on state and civil institutions; (2) the effect of capital inflows on recruitment into the bureaucracy and the private sector; and (3) the way in which access

20. H. Mahdavy, "The Patterns and Problems of Economic Development in Rentier States: The Case of Iran," in M. A. Cook, ed., *Studies in the Economic History of the Middle East* (London: Oxford University Press, 1970).

21. The implicit argument is that since different clusters of state institutions develop at varying rates, the concept of the "state" must be disaggregated to be meaningful. External capital inflows affect different capacities unequally, making the exercise of disaggregation even more important in countries that depend on exogenous capital. The implementation of extractive, redistributive, and distributive policies requires regulatory and administrative institutions whose tasks may or may not overlap. Extractive policies and institutions may perform redistributive functions (through progressive tax schedules, for example), and redistribution implies the prior extraction of resources. Distributive policies, however, are distinct from both, since they do not involve redeploying resources that were extracted from the domestic economy. Theodore Lowi's useful typology of regulatory, distributive, and redistributive "coalitions" actually are all subdivisions of my "redistributive" category, since they exist within the context of an extractive state. Theodore Lowi, "American Business, Public Policy, Case-Studies and Political Theory," *World Politics* 16 (July 1964), pp. 677–715.

22. Jacques Delacroix, "The Distributive State in the World System," *Studies in Comparative International Development* 15 (Fall 1980), pp. 3–22.

23. Philippe Schmitter's classification of "exclusive" or "inclusive" corporatism does not quite capture the quality of the links between oil states and their populations. Still, if modified to include the patrimonial/clientalistic aspects of state spending in oil exporters, it would appear to be the most appropriate framework for describing these relationships. See Philippe Schmitter, "Still a Century of Corporatism?" in F. Pike and T. Stritch, eds., *The New Corporatism* (Notre Dame, Ind.: University of Notre Dame Press, 1974).

24. The best argument on the special financial burdens of late industrialization is still Alexander Gerschenkron's *Economic Backwardness in Historical Perspective* (Cambridge, Mass.: Harvard University Press, 1963). Ample support for the argument is found in the comparative articles in Rondo Cameron et al., eds., *Banking in the Early Stages of Industrialization: A Study in Comparative Economic History* (New York: Oxford University Press, 1967); and Rondo Cameron, ed., *Banking and Economic Development: Some Lessons of History* (New York: Oxford University Press, 1972).

25. John Ikenberry, "The Irony of State Strength: Comparative Response to Oil Shocks in the 1970s," *International Organization* 40 (Winter 1986), pp. 105–37.

26. Theda Skocpol, "Bringing the State Back In," in Evans et al., *Bringing the State Back In*, p. 4; and Stephen Krasner, *Defending the National Interest: Raw Materials Investments and U.S. Foreign Policy* (Princeton, N.J.: Princeton University Press, 1978), pp. 55–57.

27. Eric Nordlinger, *The Autonomy of the Democratic State* (Cambridge, Mass.: Harvard University Press, 1984).

28. Theda Skocpol, "Rentier State and Shi'a Islam in the Iranian Revolution," *Theory and Society* 11 (May 1982), pp. 265–84. See also Eqbal Ahmed's "Comments on Skocpol," *Theory and Society* 11 (May 1982), pp. 293–300.

29. Theda Skocpol, *States and Revolutions: A Comparative Analysis of France, Russia and China* (London: Cambridge University Press, 1979).

TABLE 2. *Saudi Arabia and the Yemen Arab Republic: expectations and outcomes in boom years (1973–83) and recession years (1983–87)*

Country	*Independent variables*	*Intervening variable*	*Expected relationships*	*Outcomes in boom years*	*Outcomes in recession years*
Saudi Arabia	State-controlled oil revenues.	Low bureaucratic development. Inflow representing high percentage of GNP. Primordial cleavages (tribal and regional).	Strong, autonomous state. Dependent private sector. National integration and political acquiescence through state spending.	Strong state dominates economy. Decline of old private-sector and local associations. Decline of extractive institutions. Rise of distributive institutions. Rise of new state-sponsored private sector. Primordial cleavages unite state and business.	State unable to regulate, tax, or withdraw subsidies, to provide welfare programs, and so forth. Extractive institutions not reactivated. Private sector blocks austerity programs. Privatization of state-owned enterprises instituted to benefit the private sector.
Yemen	Privately controlled remittances (dispersed among 1.8 million Yemeni migrants).	Low bureaucratic development. Inflow representing high percentage of GNP. Primordial cleavages (sectarian and regional).	Weak, dependent state. Strong, autonomous private sector. Equal income distribution. Strong local participatory institutions.	Weak state is dependent on foreign aid. Strong, autonomous private sector. Entrenchment of old private sector and participatory institutions. Decline of extractive institutions. Primordial cleavages divide state and business.	State imposes drastic tax and regulation. Rise of extractive and regulatory institutions. Private sector unable to block austerity policies. State abandons laissez-faire policies and sets up state-owned enterprises to monopolize imports and domestic production.

to external capital interacted with existing tribal, regional, and sectoral cleavages.[30] The broad trends can be summarized as follows.

First, the primary structural impact of external capital inflows on the state in both the remittance and the oil case is the dismantling of extractive institutions. Large volumes of publicly and privately controlled capital inflows transform the tasks that bureaucratic structures are required and able to perform and precipitate the decline of regulatory and extractive institutions.

Beyond this basic similarity, two dominant patterns emerge. In the first cluster of cases, consisting of countries in which the revenue is controlled exclusively by the state, extractive institutions decay, and bureaucracies designed exclusively to distribute revenues assume their place. Institutional mechanisms for extraction and redistribution are not merely arrested; they actually decline. Regardless of regime type or level of development, state-controlled capital inflows enable governments to avoid the extraction of revenues and to shelter themselves from the political and social conflict that accompanies taxation and the centralization of the legal and fiscal instruments of the state. In the second cluster of cases, consisting of countries in which revenues enter the economy through the private sector, bureaucracies that previously had strong extractive apparatuses contract their capacities to tax, relying heavily on customs duties and other indirect forms of taxation. When remittances decline, expendable income drops, as do imports and customs duties. The narrow basis of state revenues ensures that state coffers are depleted, creating a fiscal crisis.

At a superfical level, relief from the need to tax would appear to be an administrative and political bonus—particularly in the initial stages of extraction, when resistance to central authority and taxation is strongest. However, the decline of extractive institutions bodes ill for the long-term development of all parts of the bureaucracy. Extractive institutions are the base of administration, without which regulation and redistribution are im-

30. In most Middle Eastern, Asian, and African countries, the tribal, sectarian, ethnic, and regional groups tend to be concentrated either in the bureaucracy and the army or in the private sector. In Syria, the army and bureaucracy are dominated by the Alawi minority, while the private sector is controlled by Sunis from Damascus and Aleppo. In Iraq, the state is dominated by the Suni majority of the north; the commercial class was predominantly from the southern Shi'a areas until oil wealth precipitated the emergence of a new state-created Suni industrial class through state contracts, loans, and subsidies. Similar patterns are found in Pakistan, India, Hong Kong, Taiwan, Lebanon, Kuwait, Nigeria, Guinea Bissau, and the United Arab Emirates. See Donald Reid, "Syrian Christians: The Rags to Riches Story and Free Enterprise," *International Journal of Middle Eastern Studies* 1 (October 1970), pp. 358–367; Hanna Batatu, "Some Observations on the Social Roots of Syria's Ruling Military Group and the Causes of Its Dominance," *Middle East Journal* 35 (Autumn 1981), pp. 578–94; Nikolas van Dam, "Sectarian and Regional Factionalism in the Syrian Political Elite," *Middle East Journal* 32 (Spring 1978), pp. 201–10; Michael van Dusen, "Political Integration and Regionalism in Syria," *Middle East Journal* 26 (Spring 1972), pp. 123–36; Hanna Batatu, *The Old Social Classes and the Revolutionary Movements of Iraq* (Princeton, N.J.: Princeton University Press, 1978); and George Lenczowski, ed., *Political Elites in the Middle East* (Washington, D.C.: American Enterprise Institute, 1975).

possible. Setting up an extractive apparatus is the most "intrusive" and first economic act of the state, involving the centralization of the fiscal apparatus, territorial control, political and economic decisions about target groups, the acquisition of information, and the design and implementation of collection mechanisms and enforcement procedures. The political dimension of the process includes setting long-term economic and fiscal priorities and codifying legal obligations.[31] Institutions for taxation spin off related agencies, leading to a diversification of the tools available to decision-makers. In developing countries in which there are large parallel markets in goods and currencies and in which monetary tools are limited, taxation and the data collected through this process comprise one of the few means to regulate the private sector and guide the economy.

Further, the extractive, redistributive, and distributive functions of the bureaucracy require different types of information gathering. Thus, the fiscal needs of the state affect not only what the government does but also what it knows. Without adequate information, state spending is more likely to be informed by primordial ties and political considerations rather than by economic rationality. The absence of basic data on the economy has negative effects on the quality of local investments, particularly when there are many new and inexperienced entrants to the business community. Needless to say, taxation policies condition the practices of the private sector in important ways. Commercial and investment taxes have a ripple effect, forcing entrepreneurs and merchants to adopt uniform management techniques and accounting procedures.[32] They promote sound evaluation of projects based on close study of market needs and profit margins. Besides directing investment and consumption patterns, taxation is crucial in defining societal expectations from government. Demands for political participation have more often than not been a response to taxation.

Second, the type of exogenous capital determines the relative strength of administrative and participatory institutions by awarding either the state or recipient social groups financial autonomy. Oil revenues breed large, fiscally autonomous distributive states that undercut the development of political and economic institutions in the private sector by displacing old economic groups and creating new clients through state spending. These relationships, like the internal structures of the bureaucracy itself, come under great stress

31. The European variant of the process is explored in Charles Tilly, ed., *The Formation of Nation-States in Western Europe* (Princeton, N.J.: Princeton University Press, 1975); Perry Anderson, *Lineages of the Absolutist State*; and Charles Kindleberger, *A Financial History of Western Europe* (London: Allen & Unwin, 1985), pp. 158–76. This argument finds ample support and documentation in Carolyn Webber and Aaron Wildavsky, *A History of Taxation and Expenditure in the Western World* (New York: Simon & Schuster, 1986), especially pp. 228–489; and Harold J. Berman, *Law and Revolution: The Formation of the Western Legal Tradition* (Cambridge, Mass.: Harvard University Press, 1983), chaps. 13, 14, and "Conclusion" and especially pp. 510, 533, and 534.

32. Lowell Harris, "Property Taxation and Development," in N. T. Wang, ed., *Taxation and Development* (New York: Praeger, 1976), pp. 1–64.

during the sudden changes that characterize these economies, revealing the political fragility and social vulnerability of the government. Despite their structural autonomy from society, bureaucracies based on external capital inflows are exceptionally brittle: revenues afford them the luxury of remaining highly undifferentiated and inflexible at the same time that distributive policies artificially stem the demand for and the evolution of participatory institutions.

Initially, remittances also weaken central state institutions, enabling them to contract their extractive apparatuses. But as state institutions recede from the countryside, remittances provide the resources to meet local requirements for infrastructure investment and engender both resources and incentives for the emergence of strong local participatory institutions from below. In Yemen, remittances provided the funds for donations that supported the activities of hundreds of local cooperatives, which were vital participatory civil institutions led by democratically elected leaders. In times of administrative crisis, such as the one precipitated by the recession, these local institutions became the vehicles for the extension of state control. Through the local cooperatives, remittances actually facilitated the state's penetration into the countryside during the recession, enabling it to establish a strong local presence without incurring the heavy financial and administrative burdens associated with building an entirely new institutional structure. State capacity was therefore enhanced, not diminished, by strong institutions in civil society.

Most important, labor remittances and oil rents have opposite effects on the composition, vitality, and political character of entrepreneurial groups and capital accumulation in the private sector. The impact is twofold. First, capital inflows rearrange income distribution patterns, whether directly, as in cases with privately controlled revenues, or indirectly, through state spending. Second, the sectoral allocation of resources conditions the ability of private-sector elites to press their demands upon the state.

In countries in which external capital is controlled by the state, the entrepreneurial class is highly dependent on the favor and financial support of the government. Created through state financing, this class is likely to solicit government intervention in the economy. Indeed, in extreme cases, the new domestic entrepreneurial class is the creation of the state, representing a mixture of patrimonial and corporatist tendencies.[33] Although in the short term distributive measures lead to the growth of government institutions designed to ensure social acquiescence and economic plenty, they also entangle the government in the task of mediating between different economic and social groups. The demands for mediation grow as economic hardship

33. Philippe Schmitter, "Still a Century of Corporatism?"; Suzanne Berger, ed., *Organizing Interests in Western Europe* (New York: Cambridge University Press, 1982); and Alfred Stephan, *State and Society: Peru in Comparative Perspective* (Princeton, N.J.: Princeton Uni-

intensifies conflict among domestic groups.[34] State spending is informed by the political exigencies of the time. In the Saudi case, this meant the elimination of the old private sector and the creation of a new group of business elites with strong regional and tribal ties to the bureaucracy and the ruling family of the Al Saud.

By contrast, private-sector elites in remittance economies are independent of the state and rely on a large, informal, unregulated financial market for foreign exchange. Autonomy from protection, funding, regulation, and even the practice of getting permits for imports and industrial investments weakens ties between the private sector and state elites during periods of economic plenty. The price of independence is that the lines of communication and access atrophy, making private-sector elites the easiest target in times of economic recession. In particular, when patterns of recruitment into the bureaucracy and the private sector cleave along sectarian and regional lines, as in the case of Yemen, bureaucrats are unconstrained by personal and kinship ties and can implement policies with impunity.

When international market shocks precipitate a drastic plunge in oil and remittance earnings, they prompt fiscal stringency, regenerating efforts to cut spending, tax, and regulate. These attempts are met with resistance, which forces governments to bargain with local groups, to repress opposition, or to face destabilization. In times of economic crisis, two sets of barriers to economic reform emerge: institutional and administrative inadequacy on the one hand and political protest against austerity measures on the other. As a result of the effects of external capital, the governments of both Saudi Arabia and Yemen entered the recession with tightly circumscribed regulatory and extractive capacities. Thus, at the onset of the recession, institutional impediments to reform were almost identical in the two cases, and explain only a small part of the variation in outcomes.

In the recession, the key constraints on economic policy were political. In crises, the actions of both the state and business elites are bound by the contours of business-government relations as they evolved during the boom period. In Yemen and Saudi Arabia, the sectoral distribution of remittances and oil revenues interacted with existing tribal and primordial divisions in very different ways and affected patterns of recruitment into the public and private sectors.[35] As a result, primordial cleavages were accentuated and

34. Ikenberry, in "Irony of State Strength," describes a similar pattern in advanced industrial states.

35. Samuel Huntington views the rise in violence in developing countries as a result of the government's inability to respond to demands from social groups. In contrast, Clifford Geertz and Yousef Cohen et al. argue that the rise of violence and primordial sentiments is a predictable response to state penetration in both late and early developers. I subscribe to the latter view and argue, further, that the unequal control over external capital inflows intensifies primordial divisions, thereby making the eventual reconciliation of social cleavages a more difficult process. See Huntington, *Political Order in Changing Societies*; Clifford Geertz, *The Interpretation of Cultures* (New York: Basic Books, 1973), pp. 255–310; and Yousef Cohen et al., "The Paradoxical Nature of State-Making: The Violent Creation of Order," *American Political Science*

institutionalized, dividing business and the bureaucracy in Yemen and uniting them in Saudi Arabia.

In the midst of the economic crisis, the strong and autonomous Yemeni business elite was the exclusive target of state tax and regulatory policies. Where the political will existed, state institutions were strikingly resilient. Central offices of economic ministries in the capital were swiftly reorganized, and existing local institutions were used to penetrate the countryside. Sectarian and regional polarization between business and the bureaucracy made gains in centralization and institutional entrenchment possible, suggesting that in some cases the goal of state-building conflicts with the goal of national integration.

By contrast, the task facing the Saudi government was more difficult, since it involved not only the revitalization of atrophied state apparatuses but also the dismantling of distributive agencies and the complex web of economic links that had been created between bureaucrats, princes, and entrepreneurs. State spending in the boom aimed to create a base of social support, but the state's clients in the private sector were not loyal when threatened with the withdrawal of funding in the recession. Strong tribal ties between the state-created business class and the Saudi government precluded the successful implementation of a mild set of economic reforms that aimed not so much to tax or regulate but merely to prune existing subsidies.

External revenues that accrue to private groups create a strong, autonomous business class that, paradoxically, is unable to influence economic policies. Indeed, in cases in which autonomy results from external revenues, the private-sector groups that are "autonomous" of state patronage and finance might become politically weaker than the business groups that are directly dependent on state funding. Similarly, state autonomy based on external capital inflows undercuts the long-term process of institutional development and constrains state capacity in times of crisis.

These findings contradict notions about the relationship between state size, state strength, and autonomy. The oil case suggests that the size of the state's role in the economy is not a good indicator of efficacy and capacity. In many developing countries, where direct state participation in the economy is often a substitute for strong regulatory institutions,[36] the size of the domestic role of the state does not necessarily measure its extractive, regulatory, and political capacities.[37] In cases in which the domestic bourgeoisie is in favor of strong protection or subsidization, withdrawing from a mediatory role often requires stronger domestic regulatory and political capacities than intervention, protection, or direct control of production. In late developers that depend on external capital, the tendency for different parts of

36. Kiren Chaudhry, "The Shifting Fortunes of the Public and Private Sectors in Oil Exporters: Privatization in Saudi Arabia and Iraq," paper presented to the Social Science Research Council and the American Schools of Oriental Research, 1987.

37. [illegible]

the bureaucracy to develop at uneven rates and sequences is even greater. Thus, whether the size of the bureaucracy and the scope of its operations is an indicator of domestic strength or weakness can only be assessed by disaggregating regulatory, coercive, extractive, and distributive institutions.

Further, when it is based on external resources, structural autonomy has little to do with efficacy in times of crisis. This finding contradicts key assumptions in the literature and points to the dual dangers of employing the concept of autonomy inductively and confusing *structural* autonomy with the power to realize policy preferences.[38] Much of the literature that proclaims to represent the "new institutionalism"[39] assumes the presence of state bureaucracies and stable borders as a point of departure. The focus has been on the ways in which institutional structures influence policies and institutions or regenerate the conditions for their existence,[40] not on the confluence of exogenous and endogenous forces that *forge* bureaucracies and delineate the scope of their operations.[41] Studying the process of state-building and business-government relations in the context of financial autonomy takes us a step away from institutional determinism and exposes the ways in which state bureaucracies are themselves derived from international economic forces. Strong governments might harness international capital inflows to augment their autonomy, but the relationship does not hold in cases that are exceptionally dependent on volatile international capital and involve weak bureaucracies that preside over unintegrated populations.

To explain the relationship between autonomy, state-building, and capacity in developing countries, policies that create national institutions by ensuring the existence or continuation of the state must be distinguished from policies that adjust to the working of the market through regulatory acts of an already entrenched bureaucracy. The first involves the creation of a centralized bureaucratic and legal apparatus that penetrates preexisting forms

38. The inductive use of the "state autonomy" concept is illustrated in Eric Nordlinger's "Taking the State Seriously," in Myron Weiner and Samuel Huntington, eds., *Understanding Political Development* (Boston: Little, Brown, 1987), pp. 353–90.

39. Theda Skocpol, "Bringing the State Back In," *Items* 36 (June 1982), pp. 1–8; and Nordlinger, *Autonomy of the Democratic State*. For a good review of what the "statist school" has in mind, see Stephen Krasner, "Approaches to the State: Alternative Conceptions and Historical Dynamics," *Comparative Politics* 16 (January 1984), pp. 223–46; Joel Migdal, "State-Society Relations in the Third World: The Nature of the State and the Structure of Society," paper presented at the Joint Harvard–MIT Seminar on Political Development, Cambridge, Mass., 1984; and David Held, "Central Perspectives on the Modern State," in David Held et al., eds., *States and Societies* (New York: New York University Press, 1983), pp. 1–58.

40. John Ikenberry, "Irony of State Strength"; and "The State and Strategies of International Adjustment," *World Politics* 39 (October 1986), pp. 53–77. Stephen Skowronek's excellent study of the United States, *Building a New American State: The Expansion of National Administrative Capacities, 1877–1920* (New York: Cambridge University Press, 1982), is an exception.

41. The latter issue is taken up in the work of Samuel Huntington, Charles Tilly, Fernand Braudel, and Immanuel Wallerstein. See also Joungwon Alexander Kim, "The Politics of Predevelopment," *Comparative Politics* 5 (January 1973), pp. 221–35.

of authority through what Yousef Cohen calls the "primitive accumulation of power."[42] The second involves correcting market imperfections to ensure the long-term stability of the economy or altering preexisting institutions to meet changing needs.[43] In practice, the two do not necessarily follow a set order in any given case, but the success of the second category of policies is contingent upon the instruments that emerge in the first process of institutional entrenchment.

When state autonomy coincides with the initial phase of state-building, it arrests national integration. Rather than gaining new spheres of influence by dislodging existing centers of power within society, state institutions are prematurely centralized before they penetrate society. Indeed, in this initial phase, the tribal, ethnic, and sectarian groups that control the state are likely to institutionalize traditional social divisions, postponing the creation of a cadre of bureaucratic functionaries and rolling back previous gains in national integration.[44]

Thus, the financial "autonomy of the state" is counterproductive when it coincides with the forging of fundamental bureaucratic institutions, signaling the future failure of the state's centralizing efforts. Initially, the state must diversify its government apparatus to integrate economic, political, ethnic, and sectarian groups and create dependencies between local conditions and central power through bargaining, force, and the selective distribution of influence. State-controlled capital inflows undermine this process and destroy incentives for strengthening extractive, regulatory, and participatory institutions. It is only after the process of building a central bureaucracy is well under way that the state can profitably distance itself from social groups or aggregate existing interests to implement policies for the acquisition of long-range social goods that lack a particular constituency.

In lieu of the particular challenges presented by rentier economies, we need to revise conventional assessments of the relationship between state autonomy, capacity, and national integration. At the very least, the cases of Saudi Arabia and Yemen demonstrate that structural autonomy does not guarantee political autonomy and efficacy either to social groups or to state institutions.

The setting: divided societies, emerging bureaucracies

With a few lapses, particularly during the politically turbulent years of the early 1960s, Saudi Arabia's economic policies more or less conformed to

42. Cohen et al., "Paradoxical Nature of State-Making."

43. Ikenberry, "Irony of State Strength"; and Peter Hall, "Patterns of Economic Policy: An Organizational Approach," in David Held, *States and Societies*, pp. 363–94.

44. Nigeria, the United Arab Emirates, Kuwait, Saudi Arabia, and Iraq all exhibit these characteristics in varying degrees.

typical patterns in late developers: imports were restricted; import substitution projects were initiated in the western province of the Hijaz; indirect taxes were expanded; and periodic temporary taxes were imposed to meet the military needs of the state.[45] Until as late as 1969, the government of Saudi Arabia was expanding its extractive capacities: customs duties were an important source of revenue,[46] but the religiously sanctioned *zakat* taxes were collected in the rich oasis of Hassa and Asir province.[47] Even nonsedentary tribes from the central province of the Nejd were pursued and taxed, provoking a series of armed conflicts when the enthusiasm of tax farmers tested the narrow limits of state legitimacy.[48] In the urban areas of the Hijaz, the Hashimite system of tax and fee collection through guild masters was centralized soon after the military unification of the country in 1932 and the introduction of uniform tax rates. The extractive apparatus of the Saudi state in this initial period was diverse, reflecting the many divisions within the pre-monetary economy.

The population of Saudi Arabia is divided into four distinct economic and political regions. The focus here is on the two groups that have historically contended for economic and political power: the tribal population of the Nejd and the old, cosmopolitan commercial classes of the Hijaz. Immediately after they conquered the Hijaz in 1926, the Al Saud often recruited administrators from the Hijaz, but their Nejdi tribal supporters increasingly dominated all levels of the bureaucracy.[49] Commerce was controlled by the old commercial families and guilds of the Hijaz, composed of transplanted Persians, Yemenis, Hadramis Indians, and Syrians.[50] This self-regulated and well-organized commercial middle class serviced the Haj economy and participated in the buoyant Red Sea trade. Based on legal codes that were enforced by representatives of the merchants themselves, the commercial community functioned in accordance with age-old agreements struck between family lineages of importers, retailers, transporters, and suppliers. The Hijazi domination of commerce continued until the mid-1970s.

The traditional Hijazi merchants and guild masters had long opposed the central government of the Hashimite Imam in the western provinces of Jeddah, Mecca, and Medina. Their antipathy to the Imam, and later the Al Saud, grew out of the incessant extraction of irregular taxes for military hardware and subsidies to warring tribes. As documented in writings from the 1920s to the 1950s, the main objection was that the state provided no protection and services in return for taxes: the guilds regularly employed their own armed contingents to guard the traffic between Mecca, Medina, and Jeddah. Well into the 1960s, the Hijazi merchants resisted the domination of the Al Saud and demanded representation (granted in the reign of King 'Abd al 'Aziz and withdrawn by King Feisal), government accountability, and a say in the way that state funds were spent. The "Hijaz for the Hijazis" movement was the longest lasting opposition to the rule of the Al Saud, though not the most violent.[51] At the onset, the old merchant class of Saudi Arabia was not powerless or unorganized. Indeed, it was able to extract concessions on such crucial issues as representation and commercial law.[52]

45. *Amr Sāmī* 5904, Islamic date 1351/8/13 (1932), "Letter from the Deputy of the King to Minister of Interior," asking the latter to inform the principality of Yanbo that the animal tax was both increased and unified at 1.5 *qursh* for all areas of the kingdom. See also Letter 5915, 1351/8/15, from the Deputy Prime Minister to the Minister of Interior; Letter 5916, 1351/8/15, from the Minister of Interior to the Emirate of Medina regarding the animal tax; and *Amr Malakī* 7079, 1351/11/10. The unification of tax rates and collection methods is in a single document, *Amr Malakī*, no number, 1353/3/1 (1934), which was accompanied by personal instructions from the King. See Letter from acting head of King's office, "to all Princes and Sheikhs in all the Regions of the Kingdom," *Amr Malakī* 836/1156, 1353/4/5 (1934). This letter defined obligations to the collectors from the treasury, and it insisted that all fees, *zakat*, and so on were the property of the central treasury, since collectors are salaried, not commissioned on a percentage basis.

46. Dependence on customs duties precipitated international conflict with Iraq, Kuwait, and Turkish garrisons based in Al Hassa between 1914 and 1930. See Public Record Office and Foreign Aid Office (PRO/FO) vol. 2142, especially 44/26063/14 (1914) and 44/28966/14 (1914), for disputes with the Turkish garrisons. For customs disputes with Kuwait, see PRO/FO vols. 9997 and 12240.

47. *Memorial of the Government of Saudi Arabia: Arbitration for the Settlement of the Territorial Dispute between Muscat and Abu Dhabi on One Side and Saudi Arabia on the Other,* July 1955. For tax policies in Al Hassa province, see PRO/FO vol. 20062, E3733/486/25 (June 1936) and vol. 20064, E2227/25 (23 April 1936). In general, see Saleh al Shoeibi, "Finance Policy in the Time of King Abd al Aziz," Kingdom of Saudi Arabia, Ministry of Finance, unpublished paper, 1985 (in Arabic).

48. On the tribes of Al-Lays, see *Qarār Majlis al-Wukalā'* 127, 1357/4/11; on the Asir region, see *Qarār Majlis al-Wukalā'* 123, 1357/4/8. One of the demands of the Ikhwan rebels in 1928 was the removal of taxation on the Bedouin; see PRO/FO vol. 13713, E114/3/91 (November 1928). In 1927 and through most of the 1930s, there were disputes between Kuwait, Iraq, and Saudi Arabia on the taxation of Bedouin that migrated into the kingdom during seasonal travels. The Saudis were the first to impose *zakat* on the Bedouin.

49. According to Awaji's survey data, as early as 1971, 60 percent of the top-level bureaucrats were Nejdi; 28 percent were Hijazi; 3 percent were from the eastern province of Al Hassa; and only 1 percent were from Asir, the most populous province, believed to be the home of over 60 percent of the Saudi population. Saudi Arabia does not publish population figures, but Nejdis do not constitute more than 10 percent of the Saudi citizenry. The imbalance grew even more pronounced in the boom period. Ibrahim Al Awaji, "Bureaucracy and Society in Saudi Arabia," Ph.D diss., University of Virginia, Charlottesville, Va., 1971.

50. When the Riyadh Chamber of Commerce was formed in 1962, it had a total membership of nine merchants, while the Jeddah *al-Majlis al-Tijari* (Trade Council), which existed formally at the turn of the century and predated the creation of the kingdom, had over a thousand members by 1930. See *Ghurfah Jiddah: Qisah wa Tārīkh,* Publishing and Distribution Unit, Teddau Chamber of Commerce, 1982.

51. The latter distinction was reserved for the Ikhwan, Ibn Saud's fundamentalist Wahabbi army. The best discussion of the early years of unification is by Christine Moss Helms, *The Cohesion of Saudi Arabia* (London: Croom Helm, 1978). My observations here are based on readings in the British PRO office, the archives in Riyadh, and interviews with many members of the old Jeddah and Mecca merchant houses and with merchants and industrialists in Riyadh. The only published work on the merchant class is by Michael Field, *The Merchants: The Big Business Families of Saudi Arabia and the Gulf States* (New York: Overlook Press, 1985).

52. The 1931 text of the *Nizām al-Majlis al-Tijari,* National Archives, Institute of Public Administration, Riyadh, documents these exclusive rights of self-regulation in great detail.

In Yemen, too, direct taxation of agriculture and livestock was central to state finance before the Republican Revolution of 1962.[53] Indeed, the Imam's bureaucracy was geared exclusively to the goal of tax collection. Prior to the revolution, the Yemeni economy was exceptionally closed; most imports and exports were banned, and very high export duties were levied on grains, coffee, and hides. During the decade-long civil war that followed, taxation was sporadic. Supported by Saudi Arabia and Egypt, respectively, both Republicans and Royalists depended on external military assistance and the private donations of businessmen and tribal sheikhs. Although administrative reforms set the main institutions in place soon after 1962, they were not to begin operations until 1973.

The regional cleavages dividing Yemen were equally stark. Historically, the state has been dominated by the tribal Shias of the north, while the sedentary Suni populations of the south controlled the commercial and agricultural sectors. The old commercial class of Imamic Yemen was bifurcated. A small group of Sana'ani merchants in the north, belonging to the Zeidi subsect of Shia Islam, relied heavily on the patronage of the Imam, mostly managing state monopolies. A much larger contingent of Suni merchants from Hujarriyya, Taiz, and Ibb formed a class in absentia as they migrated in successive waves to the British free ports of Aden and East Africa to escape the conservative policies of the Imam and establish themselves as retailers, wholesalers, money changers, and importers. This Adeni contingent of Yemeni merchants returned in triumph after they funded and laid the ideological groundwork for the Republican Revolution of 1962.

The first generation of technocratic elites and ideologues in Yemen were from the more educated southern population, but as opportunity grew in the private sector, the less lucrative positions in the army and bureaucracy were left to the northern Shia tribes. The implicit understanding of the Republican pact, as it emerged after the civil war, was coexistence: the north had the bureaucracy and the army, with control over aid revenues and foreign supplies, while the southern commercial communities were left free to flourish in a laissez-faire economy.

In sum, before they became recipients of massive capital inflows, central institutions were becoming entrenched in both cases. Prior to the early 1970s, the central governments of Yemen and Saudi Arabia were involved in the disruptive process of extending control over their national territories through a combination of expanding administration, taxation, and infrastructure and soliciting the cooperation of merchants and tribal leaders. In both cases, the domestic context into which revenues entered was a politically loaded one, with business dominated by one significant regional, tribal, or sectarian group and the state by another.

53. There are many parallels in the collection and assessment methods used in Saudi Arabia and Yemen during the 1950s and 1960s. See "Memorandum of Conversations with Sir Bernard Reilly and Others at the Department of State," 3 November 1947, p. 125; "Report on Yemen by Mohammed I. Massoud," 11 November 1946, pp. 4–5; and "Report on Yemen by Mohammed I. Massoud," Enclosure 1, Dispatch 30, Yemen Series, U.S. Documents, 11 November 1946; all reprinted in Al Rashid, *Yemen Enters the Modern World* (Chapel Hill, N.C.: Documentary Publications, 1984). See also Mohammed al Aadhy, "A Brief Historical Background of the Public Revenue Growth in Old and Modern Yemeni Society," unpublished manuscript, Sana'a University, 1982; and Mohammed Anam Ghalib, *Government Organizations as a Barrier to Economic Development in Yemen* (Sana'a: National Institute for Public Administration Press, 1979).

Saudi Arabia: extractive and distributive institutions during the boom years

Initially, modest oil revenues were used to strengthen the power of the Saudi state vis-à-vis the old merchant class. From 1958 to 1973, growing oil revenues prompted a gradual change in tax policies. Stringency of collection from individuals declined, and higher taxes were exacted from corporations, businesses, and joint ventures. Incremental hikes in tax rates on commercial profits began in 1963 and were completed in 1969, when unified taxes were imposed. The new tax laws and accompanying regulations for the registration of companies, merchant houses, and agencies led to the creation of new institutions to assess and enforce the new taxes.[54] The reforms signaled the political willingness and administrative capacity of the regime to impose direct income and profit taxes on the Hijazi merchant class and civil servants, while lifting the burden from farmers, nomads, and service guilds.

In the aftermath of October 1973, a new style of administrative reform began. Suddenly, the careful process of regulation and cost-benefit analysis that typified earlier policies was undone. Without exception, all direct and indirect taxes on merchants, companies, and civil servants were lifted.[55] Import duties were scaled down to a maximum of 2 percent, and foreign companies were given tax holidays in return for compliance with the 30 percent rule, which stipulated that foreign investors subcontract to Saudi companies.[56]

Extractive institutions declined in direct relation to the diminishing importance of domestic taxation as a source of government revenue. To the extent that government departments in Saudi Arabia represent, in themselves, mechanisms for distributing wealth, they are rarely dismantled. Rather,

54. The main document is *Ta'mīm*, from the Minister of Finance, no number, 1389/5/12 (1969).

55. Announcement, Ministry of Finance and National Economy, 5784/4, 1393/4/7 (1973). *Zakat* taxes were to be distributed by Saudis themselves to poor relatives; municipal taxes, road taxes, and all other fees were withdrawn completely. *Qarār Ri'āsat Majlis al-Wuzarā'* 1653, 1396/11/15 (1976).

56. For a summary of the tax system as it was between 1973 and 1983, see 'Abd al Aziz al Dukheil, "Taxation: Implications for U.S.A. Individuals or Corporations Deriving Income from a Source in the Kingdom of Saudi Arabia and for Saudi Individuals or Corporations Deriving Income, Trading or Purchasing Assets in the U.S.A.," unpublished manuscript, Riyadh, 14 October 1983.

the previously powerful Department of Zakat and Income Tax (DZIT) became nonfunctioning, limiting itself to occasional audits of delinquent foreign companies.[57] So superfluous was the DZIT that from 1974 to 1979 the Minister of Finance, Mohammed Ab al Khail, did not even bother to appoint a director for the department.[58] Unlike DZIT, which actually had a decline in the budget and the number of employees, the Customs Department grew enormously. However, expenditures of the Customs Department far exceeded receipts as it took on the important and expensive task of ensuring that the country remained free of arms, alcohol, pornography, translations of the Quran, and Marxist literature.[59] The overall role of regulatory institutions diminished: imports, local investment, and even building zones were completely unregulated, and the state foisted large chunks of policing functions onto Saudi citizens. The most formidable task of the government, monitoring foreign labor, was decreed to be the individual responsibility of the Saudi sponsor—and after him, his family and tribe.

The growth of a myriad of new state institutions to give interest-free loans, distribute government contracts, and implement subsidy programs for food, electricity, water, and so forth coincided with the state's deliberate policy of destroying existing civil institutions and corporate groups. Institutions that relied on local initiative and resource mobilization, such as local cooperative societies and agricultural outreach programs, were stripped of their legal status.[60] The traditional service guilds of the Hijaz were disbanded and their members placed under the Ministry of Pilgrimage and Religious Endowments. The organic merchant associations of the Hijaz, including the powerful *al-Majlis al-Tijari,* or Trade Council, were forced to relocate under the state-funded Chambers of Commerce.

The regulatory and distributive functions of the Ministries of Commerce, Agriculture, and Social Affairs were separated in 1975, when the specialized state banks were moved under the Ministry of Finance, thereby disengaging the regulatory and distributive functions of the economic ministries. Thus, the Agricultural, Real Estate, Saudi, and Industrial Development Funds are

57. In 1952, *zakat* and income tax receipts represented 47 percent of government revenues; by 1971, they had declined to 8 percent; and by 1978, income tax, all other taxes, fees, and customs came to only 1.6 percent of government revenues. Derived from documents in the ARAMCO Archive, Dahran, Saudi Arabia.

58. Interview with Sheikh Hussain 'Abd al Latif, Director of DZIT, January 1986. See also Hamid al Soa'ani, "The Internal Organization of the Department of Zakat and Income Tax," Riyadh, Institute for Public Administration (IPA), 1984 (in Arabic); and Nāsir al-Bishr, "Assessment and Collection of Zakat and Income Taxes in Saudi Arabia," Riyadh, IPA, 1985 (in Arabic).

59. Figures obtained from the Ministry of Finance and the Customs Department show that the revenue generated by the Customs Department in 1974–85 was 450 million Saudi riyals (SR). Expenditures for maintaining the department in the same period were 30.3 billion SR. Interviews with Sheikh Maḥmūd Al-Rashūdī, Director of Customs Department, December 1985 to June 1986.

60. See *Regulations for Cooperative Societies,* R.D. 26, passed on 30 November 1962:

all under the Ministry of Finance and not, as one might expect, supervised by the Ministries of Agriculture, Housing, Social Affairs, and Industry.

As the state cashier, the role of the Ministry of Finance and National Economy grew tremendously. The Planning Commission was turned into a full-fledged ministry that was responsible for deciding long-term allocation of resources and sectoral development. Yet this extreme centralization of decision-making was not based on a network of information gathering and regulatory agencies. Perhaps owing to the fact that their spending policies were severed from the other ministries, the two most powerful economic institutions of the kingdom functioned in an information vacuum, relying on opaque statistics manufactured by foreign consultants who staffed the Ministry of Planning. With the decline of DZIT, the only method for collecting data on the economy was the use of contracts for government projects and customs statistics. Other forms of independent verification and information gathering atrophied, and massive projects were initiated and carried out in a blind frenzy of state spending.

The 1973–83 period casts the impact of oil rent on state institutions in stark relief. Oil wealth led to the decline of extractive and regulatory institutions, created a large number of distributive institutions, undercut participatory institutions, and centralized state spending without necessitating the penetration of society.

The distributive state and social stratification in Saudi Arabia

During the boom period, the composition of the bureaucracy was conditioned by the concentration of economic opportunity in the public sector and by patterns of tribal recruitment. Lucrative government positions went to the dominant group of Nejdi tribal elites, in a country where 33 percent of the highest income group consists of civil servants.[61] Further, there was a great deal of exchange between the bureaucracy and the private sector; a vast majority of the prominent Nejdi merchants once held positions in upper cadres of the bureaucracy or the army. After the 1975 withdrawal of the prohibition against civil servant participation in business, bureaucrats openly joined merchants in entrepreneurial ventures. In a survey conducted in 1971, 26 percent of top-level bureaucrats said that they saw their employment in the government as an opportunity to combine private and public interests.[62]

61. Ministry of Social Affairs, *Study on Changes in the Urban, Rural and Bedouin Communities,* vol. 4, *Synthesis Report,* an internal report prepared for the Ministry of Labor and Social Affairs, Kingdom of Saudi Arabia, 4 vols., Riyadh, 1981, p. 94.

62. The net result of the distribution policies has been highly unequal income distribution: 19 percent of total households subsist on a yearly income of $2,747 (U.S. dollars). Forty-two percent of the households have a total income of less than $5,494. Poverty is

Because of the sheer size of the state's role in the economy, the affiliations of bureaucrats during the boom period greatly influenced social stratification and the composition of the emerging private sector.

Whatever the legal status of distributive institutions, distributive policies must be viewed in the context of the regional and tribal composition of the bureaucracy. The powerful Ministry of Finance is dominated by the 'Aniza tribe from the Qasim area in the Nejd, a community that played an important role in the military campaigns of King 'Abd al 'Aziz during the wars of unification. Other ministries are similarly divided along tribal or corporate lines: Pilgrimage and Education for the religious elite; Industry and Commerce for the new Nejdi business elite; and Agriculture for the Al Sheikh family.

Declining extractive and regulatory institutions were soon superseded by state institutions designed exclusively to distribute wealth.[63] Distributive policies fall into four broad categories. The first category includes basic goods subsidies, utilities subsidies, free secondary and college education, and welfare and social security programs, the institutional expression of which was the birth of dozens of new government agencies. The aim of these policies was to support the general population, including foreigners, through times of high inflation. Overall, the benefits of this first category were accessible to the general population and achieved their goals. The remaining three categories of distributive policies had quite different effects, showing how state spending influenced economic stratification and the social composition of the new commercial class.

The second category, which was at the apex and was by far the most lucrative distributive measure, was highly personal and informal. It was controlled directly by the King and involved urban and rural land grants carved from collective tribal lands that had been nationalized in 1952. From the onset, these gifts set the basis for wealth accumulation in the private sector: construction, farming, and industrial subsidies came to those who had land, and the value of urban real estate rose by several thousand percent during the 1970s. During the boom years, this precious commodity was recycled in various novel ways to the benefit of princes, ministers, tribal sheikhs, and favored merchants. Early records of land gifts exist, but during the boom period, these key measures found no more institutional expression

businessmen. For very detailed survey data on the social and economic effects of the distribution policies of the state, see Ministry of Social Affairs, *Study on Changes*, vol. 3, *The Urban Community*, p. 191.

63. Total disbursed interest-free loans in 1972–73 were 154 million SR; in 1976–77, the official figure was 14.6 billion SR. See *Economic and Financial Survey of the Kingdom of Saudi Arabia*, prepared by the International Monetary Fund based on research from 3 February to 8 March 1978. By 1984, the total disbursed interest-free loans amounted to $164 billion (U.S. dollars). The total recorded formal subsidies rose from 39.7 million SR in 1971 to 101 billion SR in 1981. See *The Achievements of the Development Plans, 1970–1984*, Ministry of Planning, Kingdom of Saudi Arabia, p. 38.

than handwritten chits addressed to the Minister of Finance and signed by the King.

The third category of distributive measures included large interest-free loans for housing, personal needs, industry, contracting, and agriculture, administered by the Real Estate, Saudi, Industrial, Contracting, and Agricultural Development Funds. If land grants formed the basis for wealth, the regional and tribal ties between the grant, subsidy, and loan applicants and the civil servants assumed great importance in making the wealth grow. In light of the social composition of the bureaucracy, it is not surprising that the subsidies and the lending policies of the Saudi Agricultural, Industrial, and Real Estate Funds are enormously skewed in their regional distribution. In most cases, between 60 and 80 percent of the projects funded are in the central region, the home of the Al Saud and their chief tribal supporters.[64] The skews in government lending are even more remarkable when seen in light of the fact that the Nejd constitutes no more than 10 percent of the total Saudi population.

The fourth category of policies, which included regulations for contract sharing,[65] labor import, commissions, and rules governing the establishment and sponsorship of companies, provided a broad opportunity to profiteer[66] and gave rise to a large group of "commission entrepreneurs." In 1980, the number of Saudis engaged in some sort of private business as their prime source of income was close to 18 percent of the native work force. Of these, it is likely that about 60 percent (about 83,000) were sleeping partners of foreign companies, collecting massive commissions for sponsoring companies and using connections with bureaucrats to acquire government contracts.[67] By far the largest projects involving foreign companies were government contracts, and the bidding was biased in favor of those with access to high-level civil servants and the Al Saud. Through this process, tribal and regional ties that might have weakened prior to the boom period were revitalized. Thus, it literally paid to be from a noble Arab tribe of the Nejd, because the bureaucracy was staffed with cousins and kin.

64. Data were derived from a review of annual reports of the Agricultural, Industrial, and Housing Funds. The Saudi Fund, which gives loans for bride price, cars, and so on, does not publish reports of any kind. Some informal gifts sanctioned by the King are disbursed through this fund.

65. The 30 percent rule stipulated that foreign companies subcontract 30 percent of the total amount of all government contracts to local entrepreneurs. Lacking expertise, Saudis typically took the contracts and subcontracted their share to third parties (again, foreigners) and collected commissions and profits without actually participating in the project.

66. These rules and regulations are explained in Qaiser Javed Mian and Ann Lerrick, *Saudi Business and Labor Law* (London: Graham and Trotman, 1982).

67. Interviews with members of Chambers of Commerce, Riyadh, 1985–86, for the estimation of the total number involved in deals that would fall under the rules. These activities can range from small-scale labor import to construction contracts worth billions of riyals. The numbers are derived from Ministry of Social Affairs, *Study on Changes*. According to the report, the total heads of households in the kingdom is 776,973. The *Fourth Development Plan*, Riyadh, Ministry of Planning, 1985, puts the total Saudi male labor force [illegible]

Included also in this fourth category were "sectoral development" plans, such as the "Wheat Policy," in which government subsidies for equipment, wages, seed, fertilizer, irrigation, and operation costs favored a small group of individuals and agribusinesses.[68] To add to profits, the wheat was bought back by the state at seven times the world prices and stored or exported to African countries as famine relief aid, making the desert kingdom a net exporter of wheat.[69] Representing the most peculiar example of state spending in Saudi Arabia, the wheat subsidies created interest groups consisting of nationals with no prior economic links other than a common interest in the continuation of the Wheat Policy. The risk of creating such corporate groups through state spending emerged in the depths of the recession in 1986, when the wheat "farmers" launched a successful campaign that forced the government to continue the subsidies. By the mid-1970s, government lending and "sectoral development initiatives" emerged as the main source of private capital accumulation, increasingly benefiting a narrow group of political, tribal, and royal notables.

The tendency of the bureaucracy to favor the Nejdi tribal population in its distributive policies was exacerbated by market imperfections in the oil economy. The boom-time Saudi economy combined all the disadvantages of a command economy with the familiar pitfalls of a free market. The speed with which enormous sums of money were allocated took precedence over the long-term viability of the project,[70] favoring large projects controlled by well-connected businessmen or large landowners, while information gaps almost guaranteed that state spending would favor powerful and visible social groups.[71] Unequal access to the government was supplemented by the mar-

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number is probably inflated. The Ministry of Planning's figures on the relative employment ratios of the public and private sectors are misleading because most contracts are government-financed. Employment figures do not distinguish between foreign and Saudi nationals. William Rugh's estimate that the private sector employed over one million in 1973 is based on aggregate figures. See William Rugh, "The Emergence of a New Middle Class in Saudi Arabia," *Middle East Journal* 27 (Winter 1973), p. 9.

68. According to one reliable report, 14.2 percent of farms are held by large urban absentee landlords or agribusinesses, but these constitute 45 percent of the total cultivated area. See Ministry of Social Affairs, *Study on Changes*, vol. 2, *Rural Report*, pp. 70–71 and 133.

69. Government-subsidized prices for imported wheat are about $60 per ton for American wheat whose market price was $150 per ton. The government's guaranteed price for domestic wheat is $1,050 per ton, according to *Pick's Currency Yearbook*, 1982, pp. 654–60. Since the policy did not include any restrictions on the importation of wheat from abroad, grain could be bought at the government-subsidized price, repackaged, and sold back for the guaranteed price of $1,050. The value of connections with the Ministry of Agriculture, which processed authorizations, needs no emphasis.

70. The issue of extreme centralization is explored in Osama 'Abd al Rehman, *Petroleum Bureaucracies and the Dilemma of Development: A Study of the Administration of Development in the Petroleum Producing Nations of the Arabian Peninsula* (Kuwait: 'Alim al Mu'arifah, 1982) (in Arabic). For a descriptive-historical account, see 'Abd al-Mu'ti Assaaf, "Administrative Development in the Kingdom of Saudi Arabia," M.A. thesis, Institute for Public Administration, Riyadh, 1983 (in Arabic).

71. A single example, among many, illustrates the point. While the implementation of small-scale agricultural improvement and education projects, such as the one managed by ARAMCO

ket so that even when the government made a conscious effort to provide investment opportunities for small investors, such as the sale of stock in state-owned enterprises and public utilities, inadequate checks allowed share holdings to be consolidated among a few large merchants within six months of issue.[72] As a result, a small group of businessmen and influential persons have been the sole beneficiaries of the state-guaranteed 15 percent return on the investments in state-owned companies that routinely net huge annual losses owing to underproduction and inefficient management.[73] Thus, distributive measures began as informal, targeted spending; but with the sectoral development programs, they became increasingly linked with market mechanisms, eventually loosening state control over the allocation of resources.[74]

In short, tribal connections begot wealth; and then wealth begot wealth. The result was that in a country of four million citizens, with boom-time *annual* oil revenues of over $110 billion, 42 percent of Saudi *extended families* had an income of less than $5,400 per year in 1981. Forty-four percent of the highest income bracket are found in the Nejd, as opposed to only 12 and 9 percent from the more populous regions of the Eastern and Asir provinces, respectively.[75]

During the boom, institutional links between state and society were destroyed and replaced with tribal affiliations that informed contract awards, loans, and subsidies. Through these mechanisms, state spending replicated the tribal and regional composition of the bureaucracy in the new business class, created new interest groups, and destroyed the corporate cohesion and competitiveness of the old Hijazi merchant class. Under the umbrella of the state-subsidized Saudi Chambers of Commerce, Industry, and Agriculture, the new elite gained collective access to key ministries, which sup-

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in Al Hassa province, are highly labor intensive and require attention to detail and information on the marketing, production, and storage problems of small farmers, the Agricultural Development Bank has increasingly favored large loans for a small number of projects, with no support or follow-up assistance to either small or large borrowers. For details on the ARAMCO project, see Sami Labban, "Agriculture in the Main Oases of the Eastern Province of Saudi Arabia," unpublished paper, ARAMCO, July 1982.

72. Saudi Consulting Center for Finance and Investment, *Saudi Shares Services Company Feasibility Study*, prepared for the Saudi Arabian Monetary Agency, Riyadh, 1981. A similar variant of market distortions is described in Robert Bates, *Markets and States in Tropical Africa* (Berkeley: University of California Press, 1984).

73. Michael Grinsdale, "The Need and Potential for a Gulf Stock Market," Saudi Investment Bank, February 1985, pp. 13–17; Sayyed Yahya, *The Commercial System of Saudi Arabia: Production, Commercial Papers, Companies* (Mecca: Mecca Printing Company, n.d.) (in Arabic); Saudi Consulting Center for Finance and Investment, *Saudi Shares Services Company*; and *Arab Stock Markets: Organization and Capacities*, Research Department, Inter-Arab Investment Guarantee Corporation and the Stock Market of Oman, Kuwait, 1985 (in Arabic), pp. 175–209.

74. This section of the paper is based on a thorough review of government documents at the Saudi National Archive, Institute for Public Administration, Riyadh. Searches were conducted under the categories of "donations," "compensation," "social security," "loans," "gifts," and "subsidies," beginning with the year 1924 and ending with the year 1986.

75. Ministry of Social Affairs, ...

plemented informal access through numerous joint projects with bureaucrats and members of the royal family.

Yemen: state institutions during the boom years

Yemen has been the recipient of both development aid and labor remittances. Indeed, between 1973 and 1983, state and private finance witnessed an almost parallel growth based on two different types of external capital inflow, with almost no institutions or policies connecting the public and private economic spheres. Aid and labor remittances combined to precipitate the decline of direct taxation and regulatory institutions. Between 1971 and 1983, Yemen was the recipient of massive inflows of development and military aid, which averaged 43 percent of the total government budget.[76] Until 1981, the Gulf states paid the total current cost budget of the state,[77] enabling the government to maintain itself without enforcing the collection of direct taxes. By providing a foreign source of state revenues, aid diminished the importance of the Ministry of Finance and supported the rise of highly centralized planning institutions, similar to those found in oil exporters. During the same period, labor remittances grew at an exponential rate, reaching an estimated $3.8–4 billion by the peak year of 1981, an amount that was 126 percent of the official GNP for that year.[78] Since they were spent largely on consumption of imported goods, remittance earnings indirectly nurtured the excessive reliance of the Yemeni government on a narrow domestic revenue base that consisted exclusively of customs duties. Agricultural taxes, previously the mainstay of government revenues, and other direct and indirect taxes were discontinued.

To export labor is to export unemployment. For most labor exporters, the political and balance-of-payments benefits of labor export far outstrip the economic goal of channeling remittances to productive investments. As remittances enter the economy through unregulated, informal banking systems, controlling them requires complex and politically disruptive policies, which are magnified in cases where there is a contiguous border between the labor exporting and labor importing countries. Certainly, in the case of boom-time Yemen, the choice has been to "let the market work."

76. Percentages and figures in this section are derived from World Bank, USAID, and Yemeni Ministry of Finance sources. Recent reports put direct aid at about $1 billion. See *The Economist*, 16 January 1982.

77. Claus Burghard and Michael Hofman, "The Importance of the Oil Producing Countries of the GCC for the Development of the Yemen Arab Republic and the Hashimite Kingdom of Jordan," German Development Institute, Berlin, September 1984.

78. The CPO regularly undervalues remittances to support requests for foreign aid. This affects GNP figures. Remittances outstripped the entire state budget by an average of 500 percent from 1973 to 1976. The figure I use here is three times the official one and even then represents a conservative estimate. Information from money changers and bankers in Yemen

Until 1985–86, when foreign aid dropped to 1 percent of total government expenditures from a high of 58 percent in 1975[79] and when remittances were driven underground by the growth in the black market, the Yemeni economy was awash in foreign currency.[80] But this seeming advantage worked against the expansion of the central administration in several ways. First, unlike other less developed countries in which foreign exchange constraints put a cap on government reliance on customs duties as a source of revenue, Yemen had a foreign currency surplus. These unusual circumstances allowed the economy to remain completely unregulated: tariffs were comparatively low, but the sheer volume of imports swelled customs duties from 53 million Yemini riyals (YR) in 1971 to 2.2 billion YR in 1983. While customs receipts in republican Yemen had always been a major source of government revenue, averaging 45 to 50 percent of state revenue in the 1960s, customs skyrocketed in 1976–77 to 87 percent of the total domestic tax revenue.[81] In the extreme case of Yemen, the benefits of labor export were magnified by the ease with which remittances were taxed through customs duties, and the extractive institutions of the state eventually contracted to nodes at the border. As the Yemeni dependence on customs and aid grew, the Ministry of Finance and its local branches atrophied when the Customs Department was administratively and organizationally separated from it.[82] The success of this strategy was contingent upon the continuation of labor remittances, and the risks of heavy dependence on customs emerged in the devastating fiscal crisis faced by the government in 1986.[83]

An indirect consequence of labor export in Yemen was a narrowing of the base of agricultural taxation itself: agricultural production declined in absolute terms, becoming the first victim of the high wages offered across the Saudi border. With over 50 percent of the Yemeni labor force abroad at any given point, labor-intensive agricultural taxation ceased to be a practical option for a country that was simultaneously classified as "least developed," "capital-surplus," and "labor short."[84]

79. Derived from the national budget accounts of the Ministry of Finance.

80. Estimates derived from extensive interviews with migrant agents and money exchangers (representing 80 percent of the transactions), Sana'a, December 1986 to May 1987; and interviews with Ali Salami, Controller of Banks and Foreign Currency, Central Bank of Yemen, Sana'a, May–June 1987. Most of the decline is not in earnings abroad, but represents the amount of remittances that are redirected to the foreign accounts of businessmen by the money exchangers. Kiren Chaudhry, "Between the Mattress and the Bank: Informal Banking in the Yemen Arab Republic," unpublished manuscript, 1988.

81. Chaudhry, "Between the Mattress and the Bank."

82. Othaman Mohammed Othman, "Planning in the Context of Incorrect Information: Planning Statistics in Yemen," *Finance and Industry*, no. 6 (Kuwait: Kuwait Industrial Bank, 1985).

83. For a detailed discussion of the penalties for excessive reliance on customs duties, see John F. Due, *Indirect Taxation in Developing Economies: The Role and Structure of Customs Duties, Excises and Sales Taxes* (Baltimore, Md.: Johns Hopkins University Press, 1970).

84. Migrant agents estimate that the total number of Yemeni migrants is approximately 1.8 million, which is more than three-fourths of the work force. Official figures from the Yemeni Union of Migrants places the number at 1.3 million, while the Yemeni government and the

At the same time that customs duties allowed the government to contract its extractive institutions, development aid encouraged the centralization of planning and spending institutions in the Central Planning Organization (CPO).[85] Foreign donors, preferring to work with an institution that they created, increased the relative power of the CPO, and this disconnected the decisions about resource allocation from the development of basic regulatory institutions.[86] Placed under Mohammed Attar (director of the CPO), the Ministry of Finance, Supply, and National Economy and the Central Bank became nothing more than conduits for foreign aid and customs revenues.

The decline of central extractive and regulatory institutions was coupled with the birth of hundreds of local cooperatives that undercut the authority of the landed elite in the south and took on many of the responsibilities of the state, including taxation and infrastructure. The cooperatives represented a response to the receding presence of the central government and were funded by donations from laborers and their families. Thus, although the organs of the central state atrophied, the fact that remittances distributed income directly to the rural areas created alternative institutional structures to meet the needs of the migrant communities of the south.

Remittances and social stratification in Yemen

Remittances produced income distribution patterns very different from those typical of oil revenues. If the distributive policies of the Saudi government fostered unequal incomes and generated tribal links between business and the state, labor remittances cut across pre-existing social and economic hierarchies in the labor-exporting regions of the southern provinces, with very different effects on entrepreneurial development.

Migrants generally come from the rural areas in the south, and remittances find their way back to the remote villages of Yemen through money exchangers and their retinue of subcontracting migrant agents.[87] Charged with physically transporting currency to the families of migrants, the *wuqala mughtaribeen* offer speedy services, better exchange rates, lower costs, and personal trust unmatched by the commercial banks. Commercial banks tapped the remittances by purchasing foreign currency from exchangers. Thus, remittances were the source of foreign currency for the informal and unregulated foreign exchange market that supplied domestic importers and entrepreneurs. During the boom period, access to foreign currency and investment capital was thus completely unregulated by the state. If distribution patterns in Saudi Arabia concentrated wealth in the cities alone, in Yemen the most dramatic change was in the resources available to the rural poor. Remittances changed the composition and structure of rural markets and created a group of rural merchants and consumers.[88] Unlike the case in Saudi Arabia, however, the old merchant class continued to dominate the upper echelons of industry and trade in the urban areas of Yemen.

Since the Republican Revolution of 1962, the Yemeni private sector has been dominated almost exclusively by returnees from Aden. Migration to the Gulf, like earlier waves of migration to East Africa and Aden, was heaviest from the southern Suni agricultural areas of Ibb and Taiz, where landlessness made migration attractive. Unlike the early migration to East Africa and Aden, migration to the Gulf did not spawn a highly skilled and wealthy business elite. Rather, returnees to urban areas became retailers, wholesalers, and workshop and restaurant owners.[89] Consumption fueled imports and industrial investment, creating opportunities for the old business elite.[90] Remittances completely replaced traditional merchant-landlords in the rural areas and created opportunities for new small- and medium-scale entrants into the urban business community, without displacing the older merchant houses. As a result of migration, all levels of the private sector were dominated by Suni southerners, while the government and army remained the preserve of the northern tribal Shia population.

The most striking effect of remittances was the emergence of over two hundred democratically elected grassroots organizations in the south. The cooperatives were funded by local donations from a surplus doubtless created by labor remittances.[91] As the central administration receded from the countryside, local populations formed development cooperatives that utilized surpluses from remittances to undertake the development of infrastructure, education, and health.[92] Development expenditures by these co-

85. By far the best work on the subject is 'Abd al 'Aziz al Saqqaff, "YAR Government Budget Planning, Implementation and Trends," unpublished paper, Sana'a, January 1985.

86. The nonfunctioning Land Registration Department is a good example of this. See also section on "Administrative Development" in *Mobilizing Domestic Resources in the YAR* (Washington, D.C.: International Bank for Reconstruction and Development [IBRD], 1982); and Richard Gable, "Government Institutions in the YAR," unpublished paper, USAID, 1982.

87. For a partial account, see Lee Ann Ross et al., "An Informal Banking System: The Remittance Agents of Yemen," Working Note no. 12, Rural Development Committee of the Yemen Research Program, Cornell University, November 1981.

88. Most of the new merchants in the rural areas of the south used to be migrants and are now migrant agents, according to the survey conducted by the author in Al Udain, Ibb Province, April 1987.

89. Mohammed Cassam and Dickinson Miller, "Private Sector Assessment: YAR," unpublished paper, Sana'a, February 1985.

90. My survey of Sana'ani market areas showed that although the old local merchant families retained control of traditional markets in the old city, eight out of every ten retailers in the new shopping areas are ex-migrants to the Gulf.

91. For the best synthesis of the literature on rural development in the YAR, see John Cohen and David Lewis, "Capital Surplus, Labor-Short Economies: Yemen as a Challenge to Rural Development Strategies," *American Journal of Agricultural Economics* 61 (August 1979), pp. 523–78; John Cohen et al., "Development from Below: LDAs in the YAR," *World Development* (November–December 1981), pp. 1039–62.

92. See Sheila Carapico, "The Political Economy of Self Help: Development Cooperatives in the Yemen Arab Republic," Ph.D. diss., State University of New York, Binghamton, 1984,

operatives outstripped government project spending by over 300 percent in the 1973–80 period.[93] Initially focusing on road construction, schools, and clinics, the cooperatives later branched out into irrigation projects, farming cooperatives, and poultry farms.

The cooperative movement began and grew in the south, the home of the vast majority of migrants, while the northern provinces of Sana'a, al Jawf, Marib, and Sa'ada maintained strong tribal organization. Initially a way of aggregating local capital for development projects, the cooperatives took on an overtly political character, accentuating the longstanding cultural, political, and sectarian differences between the northern and southern provinces of Yemen. Recognizing both the potential and the threat of the highly independent local development cooperatives, the Yemeni government aggregated them under the central umbrella of the Confederation of Yemeni Cooperatives in 1978.[94]

Local resistance to the first centralization of the cooperatives was partially ameliorated by two major concessions that reflected the bargaining power of the cooperatives: the local development cooperatives were to collect and spend 75 percent of local *zakat* dues as well as several indirect taxes, and they were to elect their representatives to participate in a national congress consisting of all local development cooperative leaders. The government strategy strengthened the political presence of the state in the remote areas of Yemen, allowing a weak central administration to retain at least a nominal presence in the rural communities. In some cases displacing and in others harnessing the traditional authority of local elites, the cooperatives linked the central government to local areas and opened channels for the expression of local demands. Thus, though the central government legally abrogated control over local revenues in the south, it gained a political infrastructure, buttressing its administrative weaknesses by legitimizing and coopting local power. In the recession, the expression of demands suddenly changed direction: the local development cooperatives were to undergo yet another transformation in the service of expanding the administrative authority of the central state.

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for an excellent historical account. See also 'Abd Allāh Hamīd Al-Ulufī, "The Role of Remittances on the National Economy of the Yemen Arab Republic," Department of Research, Central Bank of YAR, Sana'a, 1985; 'Abdu 'Ali-Uthmān, "The Cooperative Movement in Yemen and Development: Participation of Cooperative Organizations for Development in Projects of the First Five Year Development Plan," Report for the Council of Ministers and the CPO, 1985; and Mohammed al Ulofi, "Development of Local Administration in the YAR," M.A. thesis, National Institute for Public Administration, Sana'a, 1985.

93. Confederation of Yemeni Cooperative Associations, *Financial Accounts of the Cooperatives of the YAR*, Sana'a, several years; and IBRD, *Mobilizing Domestic Resources in the YAR*.

94. *Proceedings of the First Conference of Local Development Associations*, National Union of Yemeni Migrants, Sana'a, 1978 (in Arabic).

Contours of business-government relations on the eve of recession

Merchants, importers, retailers, and bankers have clear economic preferences and quickly identify their economic interests to support or oppose economic policies. But the true dimensions of private-sector strength are unlikely to emerge in times of economic boom. To the extent that class interests are revealed through conflict and compromise with other groups, the "boom years" ameliorated conflict. Both in Yemen and in Saudi Arabia, the political abstinence of the business class during the boom years marked a departure from previous activism. This is attributable to two major factors. First, economies in both countries were undisputedly capitalist and remained ideologically laissez faire: unfettered by debates common to other underdeveloped countries, such as competing ideologies about income distribution and the aims of economic development, the Yemeni and Saudi business elites enjoyed what were perhaps the two most unregulated economic environments in postwar history. Second, there was a pronounced absence of conflict between business and labor. In Yemen, industrialists compensated for labor shortages by using highly capital intensive machinery, a fact that would later influence the ability of local industry to absorb returning migrants. The labor force of Saudi Arabia was almost entirely foreign and was governed by labor laws that gave business the upper hand, if not virtually unlimited control.[95]

In both countries, the size of the business community grew enormously.[96] Yet the two groups were qualitatively different, as was their relationship with the central government. Unlike the case in Yemen, where, until recently, private investment has been both unregulated and free of skews produced by state funding and sponsorship, the extent of government participation in the Saudi economy is such that the task of defining the private sector is problematic.[97] State allocation of oil revenues in Saudi Arabia precipitated the demise of the old merchant houses of Jeddah, Mecca, Med-

95. Of the public-sector workers, 72 percent are Saudi. In the private sector, the percentages of lower-level jobs held by Saudis in Jeddah, Dammam, and Riyadh went from 27 percent in 1976 to less than 10 percent in 1980, with the lowest percentages coming from Riyadh and the highest from Dammam. Riyadh has the highest concentration of "independent professionals" in the country. See *Diwan al-Khidma al-Madaniyyah*, Government of Saudi Arabia, 1979–80.

96. In 1964, the Riyadh Chamber had 193 members; by 1984, the number was 18,393, according to the Chamber of Commerce, Riyadh. The growth of the merchant class in the Qasim area is perhaps second only to Riyadh, with 240 in 1979 and 5,877 in 1984. Results are from a survey conducted by the author in Saudi Arabia, 1986.

97. Work on the Saudi middle class completely ignores the existence of private-sector elites, incorrectly suggesting that the bourgeoisie consists exclusively of civil servants. See, for example, Nadav Safran et al., "The Saudi Middle Class," Center for Middle Eastern Studies, Harvard University, 1986; and Rugh, "Emergence of a New Middle Class in Saudi Arabia," pp. 7–20.

ina, and the Eastern province, and this gave rise to an entirely inexperienced and state-created group of commission entrepreneurs with strong links to the state.[98] This pattern underscores the importance of informal access to information about state contracts and projects in oil economies. The new Saudi merchants are large-scale contractors, agency holders, and importers: to the exclusion of the service guilds that still exist in Mecca and Medina, retailing and even wholesaling are done by foreigners, usually Yemenis.[99]

Yemeni business was not only completely independent of state finance but has traditionally been against state participation in the economy. In contrast, the new business group in Saudi Arabia is highly solicitious of state support and finance. Cost and price subsidies to make domestic goods competitive with imports are expected as a matter of course for factories that are themselves financed by grants, production stipends, and interest-free loans. During the boom years, the Saudi state was the puissant provider—simultaneously funding the protection of local industry, ensuring high profits for importers, and subsidizing consumers.

Needless to say, remittances and oil structured the strengths and weaknesses of private financial institutions as well. In Saudi Arabia, state lending institutions forestalled the entry of commercial banks into the industrial, real estate, and agricultural sector, while the restrictive policies of the Saudi Arabian Monetary Agency (SAMA) led to massive capital flight to Bahrain's overseas banking units. In Yemen, state lending was virtually nonexistent: the foreign exchange market was dominated by unregulated exchange houses and remittance agents. Commercial banks were essentially parasitic, functioning at the margins of a massive informal system that reached down to the rural migrants in Yemen and out into the upper reaches of international finance. In both countries, excess foreign exchange fostered a lopsided commercial banking system geared almost exclusively to financing imports. In post-boom Saudi Arabia, reliance on revolving lines of credit, which are difficult to monitor, led to the near-bankrupt status of commercial banks. To the extent that scarce finance weeds out bad investors and encourages circumspect lending, the skills of the new Saudi business class were uniformly deficient. The commission economy encouraged carelessness, and state subsidies to domestic industry bred noncompetitiveness. The informal banking system, on the other hand, posed severe constraints on the regulatory capacity of the Yemeni government, but Yemeni investors retained their famed reputation for profitable and sound investments.

While the structural factors above are important, the key to business-government relations on the eve of the recession was the alignment of ex-

98. For a different prognosis, see Ghassane Salameh, "Political Power and the Saudi State," Middle East Research and Information Project (MERIP) Report, October 1980, pp. 5–22.

99. An excellent source of information and a sample of the types of demands made by the Saudi private sector is by the Saudi Consulting Center for Finance and Investment, *The Present Status of the Private Sector and its Role in the Saudi Economy*, a study commissioned by the Riyadh Chamber of Commerce and Industry, March 1986 (in Arabic), 246 pp.

isting social cleavages with public and private sector distinctions. Between 1973 and 1986, the composition of the business class and the bureaucracy in Yemen and Saudi Arabia was conditioned by the distribution of economic opportunity in the public and private sectors, reflecting variations in the control that the state and the private sector had over oil rent and remittances. In Yemen, remittances swelled economic opportunity in the private sector, drawing in the educated southern Suni groups. The less lucrative positions in the bureaucracy and the armed forces, in contrast, were increasingly staffed by northern Shia tribesmen. During the boom period, local capital and the bureaucracy became separated by a variety of regional, sectarian, and tribal cleavages, allowing the state to distance itself from the interests of entrepreneurs during the recession. The regime's commitment to a free economy lasted only until the recession, after which the regional composition of the bureaucracy became entwined with the economic interests of the state as it struggled to replace diminishing aid revenues with local taxes.

By contrast, the new merchant class and the bureaucratic elite of Saudi Arabia were unified by tribal, regional, and economic links.[100] During the recession, these ties figured prominently in the success with which the Saudi private sector blocked government policy. Despite its financial autonomy from social groups, Saudi spending policies during the boom decade embroiled the state in the maintenance of patronage relationships that prohibited basic economic reforms in the lean years of the 1980s.

The paradox of state autonomy: conflict and change during the recession

The global recession of the early 1980s had dramatic consequences for the economies of Yemen and Saudi Arabia. In Saudi Arabia, annual oil rents plummeted from over $110 billion in the 1973–82 period to about $22.68 billion in 1986.[101] In Yemen, foreign aid declined from nearly 90 percent of the current budget to just over 1 percent.[102] In 1986–87 alone, the amount of remittances that entered the Yemeni economy plummeted by about 30 percent.[103] In March 1986, King Fahad appeared on Saudi television to announce that flux in international oil prices precluded the possibility of designing a national budget. Real estate prices plummeted as foreigners

100. For a review of the tribal basis of the state, see Mordechai Abir, "The Consolidation of the Ruling Class and the New Elites in Saudi Arabia," *Middle Eastern Studies* 23 (April 1987), pp. 150–71.

101. *Middle East Markets* 14 (January 1987).

102. *Budget of the YAR, 1986–1987*, Ministry of Finance, YARG, Sana'a.

103. This decline does not represent a decline in absolute earnings of Yemenis in Saudi Arabia and the Gulf but, rather, an increase in the amount of earnings held abroad in foreign currency owing to uncertain economic conditions at home. Interviews with money changers, 1986–87.

departed, leaving a 60 percent overcapacity in housing; banks held massive doubtful loans.

In the bust cycle, the practical difficulties of restructuring the economy in Yemen and Saudi Arabia were similar: accounting procedures in the private sector were equally primitive; extractive and regulatory institutions were equally unequipped to implement new policies; and formal links among members of the commercial-industrial class were weak. The nexus of conflicts that arose during the recession was also identical, involving the sudden need to regulate the relationship between business and labor, consumers and producers, importers and industrialists, and bankers and borrowers and to balance the fiscal requirements of the state with laissez-faire principles.

The Saudi austerity program succeeded in implementing policies that affected the general population and foreign laborers. It failed in carrying through changes that would have targeted the merchant class. Those measures that required actual institutional innovation and information gathering, such as the collection of taxes from foreign companies and of *zakat* from local ones, were unsuccessful: DZIT's heavy reliance on government contract information as a data source was obsolete at a time when few new contracts were being awarded. Attempts to tax foreign companies retroactively at the previous low rates embroiled the government in legal disputes that continue today. Many foreign companies reregistered under the names of Saudis, thereby escaping taxation altogether. In the same vein, the problems of assessing and collecting *zakat*, within the existing legal context, were prohibitive: the few companies that were audited quickly reinvested their profits abroad, thereby using a loophole in *shari'a* law to escape taxation.[104] Because Saudi companies had not previously been forced to keep formal accounts, the practical difficulties of tax assessment were great. The dual penalties of allowing the extractive institutions to atrophy were manifested in the fact that the state did not have the legal or administrative apparatus to collect any type of direct tax (corporate, individual, or religious). If nothing else, this brought home the fact that the only economic tool possessed by the Saudi state was distribution—a mechanism that can be used to encourage new investments but not to restructure the economy in lean years.

The new taxes on services affected foreign laborers and individuals: beginning in late 1985, indirect fees were collected on cigarettes,[105] and a new head tax was charged for pilgrims.[106] Profit taxes on foreign companies were

104. In typical fashion, the reinstitution of *zakat* payments was termed a "continuation" of Royal Decree 8634/28/2/18 issued on 6/29/1370. The new Royal Decree 40, 1405/7/2, stated that the "complete *zakat* would be collected from all establishments and people who are subject to it." Islamic law stipulates that *zakat* can only be collected on profits that remain in the possession of the individual for a full year. In practice, this has rarely been adhered to, even in Saudi Arabia, when there was regular taxation. Now, however, the regime is faced with having to conform to its own professed Islamic values, since the new commercial class has begun to use the same Islamic principles to its own advantage.

105. Resolution of the President of the Council of Ministers 215, 1405/11/5.

106. Resolution of the President of the Council of Ministers 254, 1403/11/14.

reinstated, although their application awaits the complete reorganization of DZIT.[107] Customs duties were increased to levels outlined in the Geneva Convention, and indirect taxes on passports, vehicle registration, visas, mailboxes, and stamps were raised by several hundred percent.[108] Port and airport fees were reinstituted for foreign transporters.[109] The new indirect taxes were easily collected through the Motor Vehicles and Customs Departments and the Ministry of Communications.

A third broad category of measures, aimed specifically at the affluent commercial class, drew stringent criticism and was unceremoniously withdrawn. In addition to progressive fees on the consumption of electricity, water, and gasoline, the policies included the new Labor Transfer Law,[110] the Saudization Law requiring that business use more expensive and less disciplined native labor, the new Social Insurance Law,[111] and the withdrawal of agricultural subsidies. One by one, these were successfully opposed through the Riyadh Chamber of Commerce and informal lobbying. More recent attempts in 1988 met the same fate: direct taxes on foreign companies and workers were announced, opposed by local business, and withdrawn within a period of three days.[112] In their opposition to regulation and tax, the Saudi private sector mobilized both primordial links and economic ties with bureaucrats and the Royal Family. Apart from the wheat farmers' use of local newspapers to voice their complaints, the grievances were expressed and heard behind closed doors. Remarkably, there was no struggle: the austerity programs were simply and quietly withdrawn. The complaints of the business class were so effective that favored local businessmen were promised a guaranteed source of future income through the massive privatization program launched in 1987. Stocks in state-owned en-

107. Bruce Palmer, "Tax Exemption Revoked," *Middle East Economic Review* (December 1985), p. 7; and interviews with officials, Ministry of Finance and National Economy, Riyadh, 1985–86.

108. Resolution of the Council of Ministers 107, 1405/6/24, and 5, 1406/1/13, for travel and passport fees. Stamp fees were raised by Decree of the President of the Council of Ministers 291, 1403/12/3; and post office box fees were raised from 25 SR to 300 SR by Decree of the President of the Council of Ministers, no number, 1405/1/26. Fees for driver's licenses were increased and the road tax was reinstituted by Decree of the President of the Council of Ministers 256, 1403/11/14.

109. See Resolution of the Council of Ministers 14, 1400/2/26, for airport fees on foreign carriers; and Resolution of the Council of Ministers 105, 1405/6/24, for the increase in port fees.

110. See New Regulations for Transfer of Sponsorship, Royal Decree M/451/8 dated 2/4/1406 (14 December 1985). This law made it more difficult for businesses to recruit foreign labor from the domestic pool, since it forced them to get approval before contracting foreign labor and to prove that no Saudi could fill the job requirements.

111. The new General Organization for Social Insurance (GOSI) law required that the employer pay his legal share of the insurance. Essentially, the law withdrew a direct subsidy that had covered the entire share of insurance paid by the employer since 1978, but it was repealed in 1986, having never been implemented. For reactions from the merchants, see "The Future of the Private Sector" and "The Eight Percent GOSI Payment," *Al-Tijarah* 28 (November 1985).

112. *New York Times*, 5 January 1988 and 6 January 1988.

terprises will be underpriced and profits heavily subsidized, at substantial cost to the government.

As revealing as the laws that were decreed and then withdrawn are the laws that were not even considered, such as legislation to reform the bifurcated legal system. When the nine "Saudized" commercial banks in the kingdom faced near-bankruptcy in 1986 owing to large doubtful credit portfolios, the government refused to amend the legal system in which Saudi nationals could choose to have their cases heard before a *shari'a* court.[113] Instead, the regime stood by the 1984 decree that prohibited foreclosure on pledged assets, thereby shoring up the plummeting real estate market, protecting the fortunes of large landowners, and upholding the supremacy of the Islamic jurists.[114] Riyadh Bank and the National Commercial Bank, both locally owned "family" banks that cater to a "traditional" clientele, were supported with massive deposits from SAMA and allowed to lower their deposits with the Monetary Agency.[115] Consistently, legislation that was against the interests of business was passed, opposed, and withdrawn, upholding the interests of Nejdi businessmen, local banks, Islamic jurists, and the landed elite against those of Saudi labor, consumers, international banks, and foreigners.

The Yemeni experience during the recession provides a stark contrast to that of Saudi Arabia. In Yemen, the drastic decline in remittances and aid during the 1983–86 period put downward pressure on the Yemeni riyal. Spurred by heavy deficit spending, a large black market emerged in the informal financial sector by late 1986. In the four months between November 1986 and February 1987, the market price of the U.S. dollar against the

113. Islamic law prohibits interest. Thus, any case involving a loan on which interest was charged would be held for the borrower in a *shari'a* court. See Peter Sloane, "Islamic Law in the Commercial World," *The International Lawyer* 22 (Fall 1988), pp. 743–65.

114. In mid-1986, a new Committee for Banking and Commercial Papers was created under the Monetary Agency. Designed, presumably, to apply the principles of secular commercial law to disputes involving interest, the committee had not commenced operations by December 1987. Indeed, it is widely believed that the committee was set up to buttress the legitimacy of Saudi Arabia as a major sovereign borrower in the future. Thus far, the Saudi Arabian Monetary Agency (SAMA) has issued bonds only for local banks, which are obliged to buy them. Interviews with Saudi British Bank (BBME), Saudi American Bank (CitiCorp), Saudi Investment Bank (Chase-Manhattan), and National Commercial Bank, Riyadh, 1985–86. For more on the bifurcated legal system, see Qaiser Jamed Mian and Anne Lerrick, *Saudi Business and Labor Law* (London: Graham & Trotman, 1982), especially pp. 217–61; and Nancy Turck, "Dispute Resolution in Saudi Arabia," *The International Lawyer* 22 (Summer 1988), pp. 415–44.

115. In the lean years of the 1950s and 1960s, the National Commercial Bank and the Riyadh Bank also lent to the state. Unlike the "Saudized" banks, which are managed by large multinational banks, the internal decisions of the local banks remain confined to the families that own them. Long relying on methods of concealing interest by making the borrower pay it in advance, the National Commercial Bank and the Riyadh Bank did not suffer from the legal system to the degree that the banks using Western management systems did. Money exchangers in Saudi Arabia also enjoy the dual privilege of being Islamic: they collect interest on loans but do not pay interest on deposits. See Michael Grinsdale, "Money Exchangers in the Kingdom of Saudi Arabia," unpublished manuscript, Saudi Investment Bank, 21 August 1984; "Saudi Branch Battle Looms Over Al Rajhi Entry," *Arab Banking and Finance* 3 (July 1984); and "Al Rajhi Rings the Changes," *Arab Banking and Finance* 3 (September 1983).

Yemeni riyal increased from the near-official rate of 6.4 YR for each U.S. dollar to 18 YR. Since the informal market met the import financing needs of merchants, the trend continued, creating a large-scale speculative market in foreign currency. The response of the government of Yemen was swift. In November 1986, all money-exchanging establishments were closed and their owners jailed. Import licenses were revoked. The Central Bank began to regulate the activities of commercial banks closely to ensure that all foreign currency was immediately transferred to the Central Bank.

Through a series of measures that are astonishing in their simplicity and in the impunity with which they were enforced, between February and March 1987 the Central Bank became the exclusive purchaser of foreign exchange. To shore up its depleted reserves, it also made six purchases totaling $600 million from Muhammad Sholaq, a money exchanger who handles approximately 75 percent of the labor remittances.[116] Then, in an effort to buy up locally hoarded foreign currency, the value of the Yemeni riyal was artificially raised in increments, enabling the Central Bank to capture locally held reserves.

To add to the effects of the ban on imports, the commercial and industrial class was hit with the direct entry of the state into importing. Presumably to stem the effects of the import ban on the prices of basic necessities, the government reserved 60 percent of all imports for the newly merged Foreign Trade, Grain, and Military Corporations.[117] The Ministry of Supply began to regularly check prices charged by retailers and to imprison and fine retailers who violated the price schedule fixed by the government.

Ironically, the ban on imports, which was designed to stem the growth of the black market in currencies, contributed to the severity of the fiscal crisis of the Yemeni state, as the most important source of domestic revenue, customs duties, declined drastically. To compensate, taxes on profit and personal income and *zakat* taxes were collected from the commercial class on a retroactive basis covering the previous six years. In pursuit of this end, the Departments of Tax and Zakat were completely restaffed and reorganized. The Tax Department conducted the first survey of commercial establishments, while the Land Registration Department was reorganized and began the first cadastral survey to be conducted in the country.[118] In its massive effort of reorganization, the government used the local development cooperatives to extend administration into the countryside by melding the Zakat Department with the Local Councils and thereby transforming existing

116. Interviews with managers of Sholaq for Exchange, December 1986 to May 1987; and interviews with money exchangers in Ibb, Taiz, Al-'Udhain, Sana'a, and Hudaydah. So successful were the government polices that for a few weeks in February the black market rate of the Yemeni riyal was higher than the official rate. On the theoretical possibility of this phenomenon, see Sanjeev Gupta, *Black Market Exchange Rates* (Berlin: J.C.B. Mohr, 1981), pp. 7–17.

117. It is important to note that this policy cannot be classified as "import substitution," since industrialists suffered equally from the ban on imported raw materials.

institutions into the local administration of the country. Locally elected officials of the cooperatives were named the mayors, tax collectors, and assessors in the rural areas of the south. Once in the government's pay, the officials were brought to the capital, taught accounting and auditing methods, given police escorts, and entrusted with agricultural taxation in the rural areas.[119] After these functional changes were effected, the cooperatives lost their local base of voluntary financial support. However, previous records of gifts and donations provided the basis for future tax assessments, and the support of the police and the remaining old landed elite ensured that these institutions did not collapse under the weight of the new adversarial relationship with the local population. Social polarization and conflict might have been the political outcomes of the reforms, but their financial success can be measured by one simple fact: at mid-year, the revenues collected by the Departments of Tax and Zakat in 1986 exceeded those of the previous year by over 300 percent.[120]

In summary, despite the financial dependence of the Saudi merchant class on state patronage, primordial links with the bureaucracy actually strengthened its bargaining power in the recession and thereby enabled it to block austerity reforms. In contrast, the independence of the Yemeni business elite from the regime translated into political weakness when the recession forced the state to make decisions concerning the relative political importance of consumers, tribal elites, and the commercial class. Indeed, the reforms of 1986 showed a dramatic shift to favor northern tribal leaders, who now receive all of the subcontracts for government imports.[121] More important, the Yemeni government was politically able to implement its highly disruptive and strong-handed policies with impunity and to extend its control into the southern rural areas, while the Saudi government was forced to withdraw from enforcing its rather mild set of reforms. Indeed, the Saudi government stepped out of the economy and began a massive privatization program, while the Yemeni government entered the domestic economy for the first time, as a competitor of the commercial class. Ironically, the subgroup of the Saudi commercial middle class that spearheaded opposition to the reforms was the state-created Nejdi elite, while their Yemeni counterparts were at once wholly independent of the state and unable to shelter themselves from stringent reforms.

119. Interview with Director of Financial and Administrative Departments, General Union for Local Councils. (This named replaced the Council for Yemeni Development Associations in 1985 with the passing of Republican Decree 12, 1985, "Establishment of Local Councils.") The actual changes are documented in "The Administrative Structure for the Local Councils," General Union of Local Councils, Sana'a, 1986. As this is a politically sensitive subject, not much has been written about it, except a short paper by 'Abd al-Azīz al-Saqqāf on "Redirecting the Cooperative Effort in the YAR," Sana'a University, 1986.

120. Interviews with Directors of the Department of Income Tax and Zakat, Sana'a, 1986–87; and review of Ministry of Finance accounts for 1968–87.

121. Figures for Yemeni grain imports, which became 100 percent government-controlled in 1986 and are managed by the Grain Corporation, a state-owned enterprise, show the following distribution of total subcontracts, with all but one going to prominent tribal sheikhs: Sheikh Al-Ruwayshān, 17 percent; Sheikh Ba Luhūm, 39 percent; and Public Loan 40, 34 percent. The figures for sugar import, also government-controlled since 1986, are equally revealing: al-Fāhim (old Sana'ani merchant family), 20 percent; Sheikh Musallim, 23 percent; and Sheikh al-Ahmar, 20 percent. For flour, all of the contracts went to Sheikh Al-Ruwayshān of Kholan. Internal memorandum, Grain Corporation of the Yemen Arab Republic, Sana'a, 1986.

Conclusion

Large volumes of external capital inflows diminish the extractive and regulatory capacities of the state. Regardless of whether they are state-controlled or privately controlled, external capital inflows have a definitive impact on state institutions. When the influx of external capital coincides with the forging of fundamental state institutions, as it did in Saudi Arabia and Yemen, previous gains in institutional entrenchment and state penetration are reversed, resulting in administrative crises in times of economic recession.

Economic policy during the recession reveals the relative weight of political and administrative barriers to economic reform. Both oil rent and labor remittances had the similar effect of destroying the institutional mechanisms required to carry out economic reforms during the recession, with the result that neither the Saudi nor the Yemeni government was administratively well equipped to manage the effects of the crisis of the 1980s. However, the differences in their post-boom responses suggest that the ability of the state to respond to economic crisis was only broadly constrained by administrative weakness. Rather, the main barriers to intrusive economic policies were political, embedded in broad social and economic changes that shifted the nexus of tribal, regional, and sectarian cleavages between the private sector and the bureaucracy during the boom period. Here, state-controlled and privately controlled capital inflows had divergent effects, which ultimately determined state capacity during the recession.

The key difference in the impact of oil rent and labor remittances was the way in which their effect on the balance of economic opportunity in the public and private sectors interacted with the social composition of the bureaucracy and the private sector. Both publicly and privately controlled capital inflows intensified existing primordial cleavages, but with very different consequences for business-government relations. It is these divergent patterns of business-government relations that explain both the differential ability of the state to respond to crises and the power of entrepreneurial groups to resist disruptive economic policies. During the boom period, the autonomous oil state created a client private sector in an effort to build a stable base of political support. Through its distributive policies, the bureaucracy replicated the tribal and regional characteristics in the new private sector that consisted of political and tribal claimants from the central prov-

ince of the Nejd. The new commission entrepreneurs cultivated strong kinship ties with the bureaucracy by expanding existing tribal relationships to include mutual economic interests. By buttressing pre-capitalist forms of identification, the spending patterns of the autonomous oil state created the context and the mechanisms for continuing demands on the state treasury. Thus, during the post-boom period, the new private sector successfully resisted state policies through precisely the kinship links with the bureaucracy that account for its ascendance during the boom years. Saudi foreign reserves are being depleted at the rate of $1 billion per month. Saudi Arabia faces limited prospects of international borrowing, and local banks gave government bond issues an unenthusiastic reception in 1984, 1986, and 1988. In light of these developments, the Saudi government can hardly continue the present policy of accommodation indefinitely.

By contrast, the boom years in Yemen separated private sector elites and bureaucrats along primordial and regional clefts, affording the state the corporate cohesion and the political will to implement stringent austerity programs in the recession. Unlike the case in Saudi Arabia, the bureaucracy and the private sector in Yemen became divided along regional and sectarian distinctions that embodied a variety of historical differences. During the boom period, the southern Suni population was drawn into the affluent private sector, leaving the army and the bureaucracy for the Shia tribal groups of the north. Remittances eroded traditional authority in many rural areas of the south, where they engendered strong local organizations to undertake functions normally performed by the state. During the recession, these very associations became the vessels for extending state administration and tax collection in the remote rural areas of the south. In the urban areas, the bureaucracy was able to generate both the will and the institutional capacity to move against the interests of the commercial class in favor of consumers and tribal notables, abrogating the pact that underpinned the Republican Revolution of 1962. At least in the short run, social distance from the private sector strengthened the political resolve of the Yemeni state. The present situation is highly unstable. Indeed, gains in institutional entrenchment were bought at the cost of social polarization. Despite the fact that the reforms are essentially fiscally sound, policy choices increasingly appear to serve the interests of the regional and sectarian groups that dominate the army and the bureaucracy.

The Yemeni private sector, though structurally autonomous from the state, was unable to resist state policies during the crisis precisely because its boom-time independence obviated the necessity of cultivating ties with the bureaucracy and the army. In neither case did structural autonomy form the basis for political efficacy. The long-term price of "money made in air" was institutional decline and intensified primordial cleavages antithetical to national integration. But during the single boom-bust cycle covered in this

analysis, state and group autonomy based on external capital inflows diminished the efficacy of those that controlled them.

The patterns of state-society relations in Saudi Arabia and Yemen reveal the importance of strong civil groups for effective state action, laying bare the danger of seeing state and civil strength as a zero-sum relationship. In Yemen, strong local groups organized along democratic lines were aggregated at the center. This experience is in stark contrast to the Saudi case, in which previously strong groups in the Hijaz were disbanded and corporate groups were created directly through state spending. The weakness of the latter pattern is that group interests coalesce only as a result of state spending patterns. Rather than forming a loyal political base, continued financial support from the state was a prerequisite for the private sector's acquiescence. Ironically, opposition to austerity measures was spearheaded not by the disenfranchised Hijazis, nor by the impoverished populations of Asir and Hassa, but by the two main beneficiaries of Saudi state spending: the state-sponsored landed elite and the new Nejdi merchant and industrial class.

These findings bear on the utility of "state autonomy" as a useful analytical category and reveal the flaws in current usage of the term as a means of defining a condition or predicting the relationship between the state and social groups. The unrelenting exposition of the virtues of "autonomy" which characterizes the recent interest in state capacity might be appropriate for the study of advanced capitalist economies in which the democratic process gives organized social groups institutionalized opportunities to block state policies. It makes less sense in countries where the main impediment to the implementation of policies is the *lack* of central institutions; where the basic process of the extension of central administrative control over territory coincides with the financial autonomy of the state; and where formal mechanisms for the expression of political priorities are weak or nonexistent and both state and society are divided along tribal and sectarian cleavages. Even the capacities of strictly autonomous states are conditioned primarily by their ability to override social opposition. Agendas that are exclusively generated by ministries of finance without input from social groups will eventually confront the scrutiny of economic elites, where the actual limits of state power are tested. Similarly, social groups that enjoy high levels of independence may find themselves left out of new coalitions that emerge in response to economic crises. Moreover, the cases of Saudi Arabia and Yemen demonstrate the crucial role of domestic social contexts in mediating the effects of capital flows to developing countries, the majority of which are divided societies presided over by fragile, emerging bureaucracies.