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Resource curse contagion in the case of Yemen ☆

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ABSTRACT

This study analyses the economic developments in Yemen from the 1970s to today in the context of the resource curse hypothesis. After a brief survey of the resource curse literature, using empirical data, historical accounts, and political (economic) analyses, I confirm that post-reunification Yemen suffers from an intense oil curse. The curse is evidenced by low genuine savings rates, oil-dependency, a stagnating economy, and institutional failure. However, this study finds that the institutional failure which caused this is itself a product of the resource-curse-like developments following migrant worker remittances from Saudi Arabia in the 1970s and 1980s. Moreover, the current instability in Yemen has its origins in rent-seeking defections in the corrupt governing patronage network due to sudden anticipations of oil exhaustion. The analysis suggests that worker migration is able to transmit resource curse symptoms to other economies, which makes them also more vulnerable to future resource curse triggers, and that declining resource reserves increase political instability of countries with strong patronage networks.

1. Introduction

The air strike interventions of the Saudi-Arabia-led coalition, following the al-Houthi takeover of 2014/2015, brought the almost forgotten Republic of Yemen back into the limelight. Yemen, a failed state and the weakest of all Middle Eastern economies, is a net exporter of crude oil and natural gas (henceforth abbreviated oil and gas respectively). Thus, that Yemen is suffering from (energy) poverty (El-Katiri and Fattouh, 2011) seems paradox. This reminds one of the economic puzzle known as resource curse: economies abundant in natural resources that exhibit bad economic performances.

Assessing this issue is of interest for resource and development economists and for analysts or policymakers of Yemen alike. In general, even though the underlying reasons for resource curses have been quite extensively studied in the past (see Van der Ploeg (2011a) for a comprehensive summary on the topic), many topics are still insufficiently examined. This includes its dynamics, the reciprocal relationship between resource curse and government, and the question why some resource-abundant economies suffer from the curse and others not. Concerning Yemen in particular, to the best of my knowledge, Al Iriani (2012) and Al Iriani and Al Eriani (2015) have been the only studies which address the resource curse in Yemen explicitly, giving evidence for its presence. Yet, the curse plays a central role in the county's history. Thus, for studying the country or designing policies for it, understanding the resource curse in Yemen and its far-reaching impacts is crucial. Until now, attempts to intervene in Yemeni politics have usually only been of modest success. For a long time, action was focussed on conditioning aid on the fulfilment of certain reforms, a policy with doubtful effects in the context of the current developments.

This study uses empirical data, political (economic) analyses, and historical accounts to examine to which extent Yemen is suffering from the curse and which factors have influenced these developments. As a result, I can confirm that today's Yemen suffers from an oil curse, supported by time series each covering more than 20 years. However, of much greater interest, I am able to show that the institutional failure that enabled the oil curse arose from the effects of workers' remittances which flew into the economy during the 1970s: a first curse, transmitted from Saudi Arabia. Implicitly, the current misery in Yemen can be traced back to the establishment and empowerment of a corrupt state apparatus, which resulted from this first resource curse. This suggests a conclusion so far not popularly considered in the literature: resource curses may be potentially contagious in the presence of labour mobility and can be transmitted to another economy, where they cause lasting damage to institutions. This in turn makes the affected economy prone to future resource curses. Al Rawashdeh and Maxwell (2013) have already made similar

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observations regarding the effect of workers' remittances in the case of Jordan. Hence, the case of Yemen supports the view that the classic understanding of resource curses might have been too narrow and should be geographically expanded and generalised to other kinds of external rents.

Today's Yemen is the product of a series of turbulent historic developments during the last 50 years. The 1960s had left Yemen torn into northern Yemen Arab Republic (YAR) and southern, communist People's Democratic Republic Yemen (PDRY). Both states had just emerged from armed conflict (a revolution against the former monarchy in the North and a liberation from British protection in the South, including interventions by Saudi Arabia and Egypt) and were mostly tribal areas with hardly any institutions or modern economic activity. This changed during the 1970s, when institutions grew quickly in the wake of a steeply rising labour demand from neighbouring Saudi Arabia, which attracted a significant part of the Yemeni work force and resulted in a large inflow of workers' remittances. Oil was discovered and exports initiated during the 1980 s, which were also marked by tribal unrest and economic setbacks under long-term president Ali Abdullah Saleh, who took over YAR's government in 1978. A reunited Yemen was established in 1990 but subject to multiple adverse macroeconomic events in subsequent years. Since 2011, persistent violent conflict between different groups and systematic government failure have finally ended in the state's complete breakdown in the form of multiple takeovers and subsequent wars, lasting until the present.

Colton (2010) is the only study explicitly acknowledging the connection between changes in Yemen in the 1970s and the economic post-reunification struggles. Nevertheless, her study is not set in the context of the resource curse literature and only touches the role of the government in Yemen, although the latter is a key variable for the analysis of these events. In this regard, I find that Yemen's path to complete state failure in this decade can be explained by the destabilisation of the governing patronage network due to incentives to defect. The tendency to turn against the government increased following lower revenues and the sudden anticipation of an exhaustion of oil reserves after the country reached its peak oil production in 2002.

The paper is structured as follows: Chapter 2 briefly reviews the resource curse literature, giving a synopsis of (recent) studies to point out the symptoms which are used to diagnose the curse later on. Chapter 3 is the analysis itself, chronologically structured, and Chapter 4 presents a brief discussion of the results' implications and a policy recommendation note for the case of Yemen.

2. Background: the symptoms of a resource curse

The following subsections explain the different symptoms of a resource curse. From the beginning, it is recognised that "the curse is real but not destiny" (Elbadawi and Gelb, 2010, p.iii), according to the consensus in the modern literature on the topic. The different economic effects (Dutch disease, price volatility) do indeed harm the economy but can be tackled – at least principally – by adequate policy. Hence, the major driver behind the curse is government failure.

2.1. The Dutch disease

Dutch disease is a term inconsistently used to describe a substantial deindustrialisation due to a growing natural resource sector, often connected to an appreciation of the (real) exchange rate. Corden and Neary (1982) have shown how a boom in the resource exporting sector leads in the first stance to labour movements from other sectors into the boom sector, later drawing further labour force from the manufacturing sector into the services sector due to the increased income, finally increasing the price of services – ergo a real exchange rate appreciation. Over time, the role of learning-by-doing effects and the crowding out of positive externalities in the manufacturing sectors have been discovered (Krugman, 1987; Sachs and Warner, 1997). More recent studies have suggested that – especially in the case of developing economies – time-inconsistent investment schemes or absorptive constraints cause the Dutch disease. Absorptive constraints describe the economy's disability to efficiently utilise its resources in terms of investment and consumption, i.e. the economy is bottlenecked by the absence of non-tradable factors such as infrastructure or human capital, an adverse appreciation of the real exchange rate, or the institutional background (Van der Ploeg and Venables, 2013).

As it may be expected, the "right" description of the Dutch disease depends on the exact situation, i.e. the economy affected and the resource involved. For instance, absorptive constraints in the form of labour may be valid in the case of Nigeria (a lack of human capital) but not for the oil-rich Gulf States, which have managed to attract skilled labour from abroad. To bypass this discussion, I adopt a perspective on the Dutch disease that is comprehensive but focussed on developing economies: Due to limited non-tradable development factors and/or a weak institutional background, export revenues are not reinvested or used efficiently. Moreover, the boom and its resulting capital inflows lead to a concentration and higher wages in the resource-associated sector and the growing services sector, provoking a real and/or nominal appreciation, harming the other industries' international competitiveness. Furthermore, missing economies of scale in the manufacturing industry lead to a relative decrease in its productivity. All these factors result in the economy's deindustrialisation.

An appreciation of the real exchange rate hampers growth through its effect on tradeables and their industry. This is especially true for developing economies (Rodrik, 2008). Concerning the effect of deindustrialisation itself, there are indeed studies which cast doubts on its negative impact on long-term growth (Sosa and Magud, 2010). However, this only applies to certain cases. With a complete resource dependency, the economy might enter a sectorial trap, which leaves it unprotected in case of substantial negative demand or supply shocks (e.g. exhaustion or technology switching), finally causing a post-boom collapse (Elbadawi and Gelb, 2010; Gelb and Grasmann, 2009). Underinvestment in education and research are further potential consequences of the concentration in natural resources (Gylfason, 2001). This leads to an undersupply (or a flight) of human capital, which prevent technological progress and, thus, long-term growth (Papyrakis and Gerlagh, 2006; Kufenko, 2015).

Optimal reinvestment patterns of resource rents can indeed differ for each economy. However, in the general case, the rents should be reinvested into renewable capital for sustainable economic growth and for preventing a post-boom collapse. Still, as part of the Dutch disease, many resource-dependent economies exhibit low savings and high consumption rates (Collier et al., 2010; Cherif and Hasanov, 2013). Majbouri (2015) estimates that, on average, Middle Eastern oil producers could have yielded 17% more income over a period of 40 years if resource rents had been invested sustainably. Sustainable reinvestment can be evaluated most effectively by a genuine savings indicator, i.e. an economy's aggregated savings adjusted for changes in assets such as resource depletion, education, and environmental factors (Hamilton, 1994; Hamilton, 2010). Hence, genuine savings are a major indicator for diagnosing a resource curse (Van der Ploeg, 2011a; Boos and Holm-Muller, 2013; Boos and Holm-Muller, 2012).