CHAPTER 1

Rentier Theory and Saudi Arabia

This chapter provides background information on the concept of rentier theory and describes the rentier characteristics of the Saudi state. In the first section I review the primary literature on rentier theory and describe essential concepts, such as rentier economy and rentier state. Section 2 provides a historical background of Saudi Arabia. In this section, I describe the creation of the Saudi state as well as politics in the era before the discovery of oil. This section concludes with a description of Saudi Arabia as a rentier state.

What is a Rentier State?

The concept of the “rentier state” was first proposed by the economist Hossein Mahdavy to identify the effects of oil nationalization on the structure and source of economic growth in the Middle East, especially in the case of Iran after the mid-1950s. Mahdavy defined rentier states as “those countries that receive on a regular basis substantial amounts of external rent. External rents are in turn defined as rentals paid by foreign individuals, concerns, or governments to individuals, concerns or governments of a given country.” 1 External rents are distinguished from foreign grants, because the latter are often of a temporary nature and uncertain. During the Cold War era, for example, several Middle Eastern states, notably Israel, Jordan and Egypt, received so-called “strategic rents” which are often listed as development aid in the World Bank statistics. 2 Although Madavy’s definition of external rent could also include labor remittances, foreign direct investment, and other capital flows, his main concern is oil rent. Being mainly interested in the economic development of Middle Eastern countries before 1970, Mahdavy’s examples of external rent include payments for the passage of ships through the Suez Canal, payments to oil transit countries, and oil revenue received by governments of exporting countries in the form of royalties from oil companies who were still in charge of oil exploration and development. In the early 1970s, however, nationalization of

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the oil industry in many oil-exporting countries modified the nature and amount of rent. Consequently, the nature of oil revenue was transformed from royalties and taxes to revenues from selling oil abroad directly.3

While all countries in the Middle East in the 1960s received external rent, the variation in added value it constituted to their GNP and the percentage it represented of their total government revenue varied significantly across countries. Therefore, “the stage at which a country can be called a rentier state is determined arbitrarily,” and Mahdavy is mainly interested in those cases where “the effects of the oil sector are significant and yet the rest of the economy is not of secondary importance.”4 The crucial point for Mahdavy is that rapidly increasing oil revenues transform governments into decisive players in the economy. Without resorting to taxation the state relies on oil revenues to finance large public projects and programs. Such dramatic increases in government expenditures, Mahdavy reasoned, would stimulate production by increasing demand. Higher demand, however, does not necessarily stimulate the productive sector of the economy, because oil revenues are largely used to import consumption goods, which cannot be produced at home. Therefore, oil revenues end up stimulating the productive sectors of countries from where goods are imported, not the local economy. The end result is that domestic economic growth remains unimpressive. A corollary of the rentier state economy is that social and political relations are also distorted by government expenditures and the absence of taxation. While small segments of the society greatly prosper from oil revenues, the rest of the society dwells in a state of underdevelopment. This situation of inequality, according to Mahdavy, does not necessarily provoke great friction because the elites are exploiting natural resources, not the people.

The Rentier State as a Sub-system of the Rentier Economy

Hazim Beblawi and Giacomo Luciani refined the concept of the rentier state in the 1980s. In The Rentier State Beblawi and Luciani refine the concept of the rentier state in several ways. First, the concept of state is redefined. Unlike Mahdavy’s definition of state, which seems synonymous with “country,” Beblawi and Luciani define the nature of the state as “the combination of essential indicators describing the relationship between the state and the economy.”5

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4 Ibid., 431.