THE STATE AND MARKET IN OMAN'S DEVELOPMENT: CONFLICT OR CO-OPERATION ?

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ADDENDA

1. Addendum after 2.4.4

Some Recent Additions to Development Literature

There are two relatively recent additions to development literature which we need to discuss briefly insofar as they have relevance for our research: the endogenous growth theory and the New Instituitional Economics. Both are extensions of neo-classical economic theories. Both have extremely wide parameters and a broad range of issues and problems can be incorporated within them.

We shall argue that whilst both new theories need to be discussed, it may be too early to evaluate their contribution to an understanding of the development process. However, as we shall see, both theories support our argument which favours state intervention in the development process, and also the significance of human capital development.

Endogenous growth theory has been pioneered by Romer (1986) and Lucas (1988). Their work has been added to considerably by others: Grossman and Helpman (1994); Yip and Zhang (1997); (Tamura 1996); Palivos (1995); and Becker et al (1990), amongst others.

The context in which endogenous growth theory has risen is the attempt to explain diiferences in growth rates of different economies, with particular momentum being derived from the success of the NICs (Crafts, 1996). In this context, the divergence/convergence debate is relavant. Within endogenous theory, the convergence of per capita growth rates have been tested by taking them as a dependent variable with per capita income as the independent variable in cross-section analyses. This has provided some useful means for hypotheses testing (ibid).

The basic premise of endogenous growth theory is that long-run growth in income per head depends on investment decisions, rather than, as in traditional growth theory, resulting from unexplained or exogenous improvements in technology. Since policies of the state can influence these decisions both directly through taxes and subsidies and directly via reform of insitutional arrangements, intervention may in principle be used to raise investment and hence the long-run growth rate

It should be noted however, that in endogenous growth theory investment usually refers to a broader concept than the physical capital accumulation reoported in national accounts; human capital and/or Research and Development expenditures may also be included. The key to endogenous steady-state growth is that there should be constant returns to this broad capital accumulation (Crafts, 1996; World Bank, 1993b). As we indicate in our thesis, a social economic transformation of Oman, which includes development of human resources, requires a set of complex and complementary policies to secure these objectives.

One of the strengths (and maybe also the weakness) of endogenous growth theory is its ability to incorporate ideas from other pre-exisiting theories both from within economics or development-related disciplines.

Similarly, whilst endogenous growth theory may not directly address problems of the developing countries, it can incorporate issues which are relevant to the latter, for example application of the theory to basic needs (Pio, 1994). Another characteristic of endogenous theory is the way it tends to extend the meaning of some concepts used in economic theory: so that human capital means not only education but also health and nutrition (Pio, 1994:278). According to Pio (1994:296-7):

> [In] a matter of a few years endogenous growth models have been developed which provide an analytical framework and policy prescriptions on a variety of topics linked to economic development. Admittedly, not all the relevant issues facing developing and industrialsed countries are amenable to analysis in a dynamic optimisation framework. Nevertheless, by focussing on the role of externalities in the development process, on the production functions with constant or increasing returns to scale, on human capital accumulation and on the political process through which economic policy decisions are reached, these models have considerably expanded our understanding, as well as our doubts, about the dynamics of economic systems.

As mentioned above endogenous growth theory supports our view on the role of the state: Pio, a proponent of the theory, suggests that after decades during which the state was seen a major determinant of development, the neo-classical backlash asserted that the state could only do harm and misallocate resources. This established the grounds for a considerable reduction in the role of the state. According to Pio, a more balanced view, prescribed to by endogenous theory now prevails, where it is recognised that in some areas state intervention is essential for promoting growth, whilst other areas are best left to the private sector (1994:284-5). Thus the role of the state becomes one of adopting policies which may be necessary to move the economy from its competitive second-best optimum and bring it closer to the optimal solution of a command economy which internalises externalities (ibid.287).

Endogenous growth theory also gives significance to human development, which figures prominently in Oman's development strategy, particularly in the Fifth Five Year Plan and Vision 2020. In endogenous growth theory, human capital accumulation is crucial for sustained development and growth. Appropriate levels of provision of health, education and nutrition are the result of either private or public resources being allocated for this purpose. If the private sector provides these resources, then a sufficiently equitable distribution of income will allow indidividuals to have access to these provisions in the open market. If the public sector is the main provider of these resources, as in the case of Oman, as we shall see, then sufficient revenues must be raised to cover the necessary expenditures (ibid.291). In the latter, therefore, the role of the state has been extremely important in Oman. Though, as chapters Six and Seven in particular show, the role of the private sector is likely to increase during the current Fifth Plan.

In endogenous growth theory, the meaning attributed to human capital relates either to a notion of a general state of knowledge, or more specifically to education.Romer (1986) considers knowledge to mean the state of availability of technology, with knowledge being rather more embodied in machines than in human beings. On the other hand Lucas (1988) places emphasis on investment in formal education and training to constitute the core of human capital.

Another new addition to development literature is provided by the New Institutional Economics (NIE)(Hariss et al, 1995). The NIE is 'new' because there is an older school of institutionalisn in economics. Thus:

> OIE [Old Insitutional Economics] may be presented as descriptive, holistic and behaviuorist and the NIE as formalist and reductionist. [Morevover], it is an explicit incorporation of the political and the social into analyses of the formation of institutions that has generated interest in institutional economics among social scientists. These characteristics, given the multi-disciplinarity of a large part of the existing literature, also point to the relevance of NIE for future research on Third World development (ibid: p.5).

In other words, NIE like the endogenous growth theory engages with and incorporates ideas from other disciplines and from particular branches of economics itself. Like endogenous growth theory NIE takes on board concepts from outside of mainstream economics: for example from those relating to legal systems, property rights and organisations, public and rational choice theory, empowerment of the individual agent, to rent-seeking behaviour and distributive coalitions, dynamics that that have an impact on transaction costs, income distribution and economic efficiency (ibid). We address these issues in our work, in subsequent chapters. Of particular relevance of this theory for our research is the significance it places on the role of institutions in development, and in particular the role of the state. The latter being especially relevant in both strategic allocation of resources, and in situations of market failure (Bates, 1995:pp.36-39).

NIE is seen to be particularly relevant for analysing third world development because of its focus on institutions and organisations. It recognises that productivity enhancing institutions can emerge through spontaneity of individual behaviour driven by optimising rarionality, without implying collective behavioural change (Harriss, op.cit.p.6).

Toye (1995: p.61) states that development used to be defined as economic growth plus structural change, whilst NIE proposes that development should be defined as economic growth plus institutional change: 'Appropriate institutional change has been elevated by the NIE to a central place in the theory of development, by contrast with neo-classical growth theory's central focus on saving and population growth' (ibid). As a critique it may be said, however, that whilst neo-classical theories of development might not have addressed issues relating to institutions, other theories (modernisation, Marxist and dependency theories) have done so. Nevertheless it should be recognised that NIE has brought to the fore, in way of a reminder, that processes other than the narrowly economic are of crucial significance in securing development, as we have stressed in our research.

Addendum to Chapter 6.5

The significance of providing strictly non-economic institutions, such as legal insitutions/framework, for protection and regulation of contracts, of property, of stock exchange, and so on, to facilitate the development process has been re-emphasised (both implicitly and explicitly) by the New Institutional Economics which we have discussed in the Addenda.

Addendum to Chapter 7.5 p.379:

We have discussed the significance of human development and human capital development including from the perspective of the endogenous growth theory in the addendum to 2.4.4 in the addendum. Here we have indicated the extended but comprehensive perspectives on human capital in the context of development.

Addendum to Chapter 8.3.4

We have indicated in the addendum the significant role ascribed to the state by the two relatively new additions to development literature, endogenous growth theory and the NIE. Both approaches argue as we have done, for the state and market to work in tandem.

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ABSTRACT

This thesis is a theoretically grounded empirical analyses of the economic and social development of Oman particularly from the mid-1970s to 1995. The analyses focuses on the major factors responsible for Oman's development particularly its development policy and strategy which involved a systematic use of both the state via the Five Year Plans and the market in inducing economic and social development of the country. These instruments were crucial in the allocation of resources to the various economic and social sectors of the country which secured relatively high rates of economic and social development. A brief historical sketch of Oman's economy and society highlights the significant transformation that the country has undergone since the inception of development planning in the mid-1970s.

The study is located within the context of the global economy and international policy and provides in particular a critical reappraisal of structural adjustment propagated by the major world organisations such as the World Bank and the International Monetary Fund. In this connection the thesis provides a critical appraisal of the 'market-friendly' 'minimal state' policies promoted (and required) by provisions under conditionality. After analysing the role of the state in the development of some countries to provide a comparative dimension, the study cautions against unselective or universal adoption of structural adjustment and the privatisation package and hence a reduction in the role of the state, which is supported by the Bank and International Monetary Fund or national governments.

The research critically appraises the various theories of development from both the development economics and development studies tradition; the study evaluates the plan versus the market debate in relation to both the two theoretical traditions and international policy of structural adjustment, and the theoretical assumptions underlying this. The thesis shows the importance of the role of the state in securing economic and social development including in some East Asian Countries. After analysing Oman's strategy in combining the

strengths of planning and the market processes in securing development, the thesis argues that contrary to the neo-classical viewpoint now dominant, the case for rolling back the state is questionable. On the contrary the thesis recommends a proactive role for the state, in a number of spheres of Oman's economy and society including in industry and agriculture. Specifically the research findings describe how a number of five year plans have succeeded in both expanding and diversifying Oman's oil-dependent economy as reflected in various indicators such as increase in per capita income and gross national product, and in increasing social welfare as indicated by greater provision of education and health services in the country.

The thesis finally offers some suggestions and recommendations in terms of dealing with future problems that Oman have to encounter, including unemployment, need for more (appropriate) trained labour force and greater diversification of the economy.

ACKNOWLEDGEMENTS

This work has occupied more than three years of my life and it has been both fascinating and intellectually stimulating. Fascinating it has been to rediscover once again how much Oman and Omanis owe to one individual, His Majesty Sultan Qaboos bin Said, for the outstanding social, economic and political progress that has been achieved over the last quarter of a century. To Sultan Qaboos I salute and offer my profound thanks for his enlightened leadership to policy making and his strong commitment to development.

To my dear friend and colleague, Qais bin Abdul Munim Al Zawawi, a sadly belated thank you. I regret he did not live to see this work, which is a testimony to the success of an experience with which he was very closely associated from 1974 till 1995.

Intellectually it has been very stimulating to interact with and be guided by Pervaiz Nazir, my supervisor. I am indeed indebted to him for his views, comments, and criticism which have not only been useful but have also provided the underpinnings for refining the work over and over again.

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Last, but not the least, I am deeply grateful to my mother, my sister Nazat and her five children, my wife Batool and my own five children. My profound thanks go to my children who had to sacrifice a lot during my frequent absences from home and my prolonged immersion in my work. Proud I shall always remain of them and for me they shall always remain a fountain of courage and love. God bless them and bless all mankind.

TABLE OF CONTENTS

List of Tables

List of Charts

List of Appendices

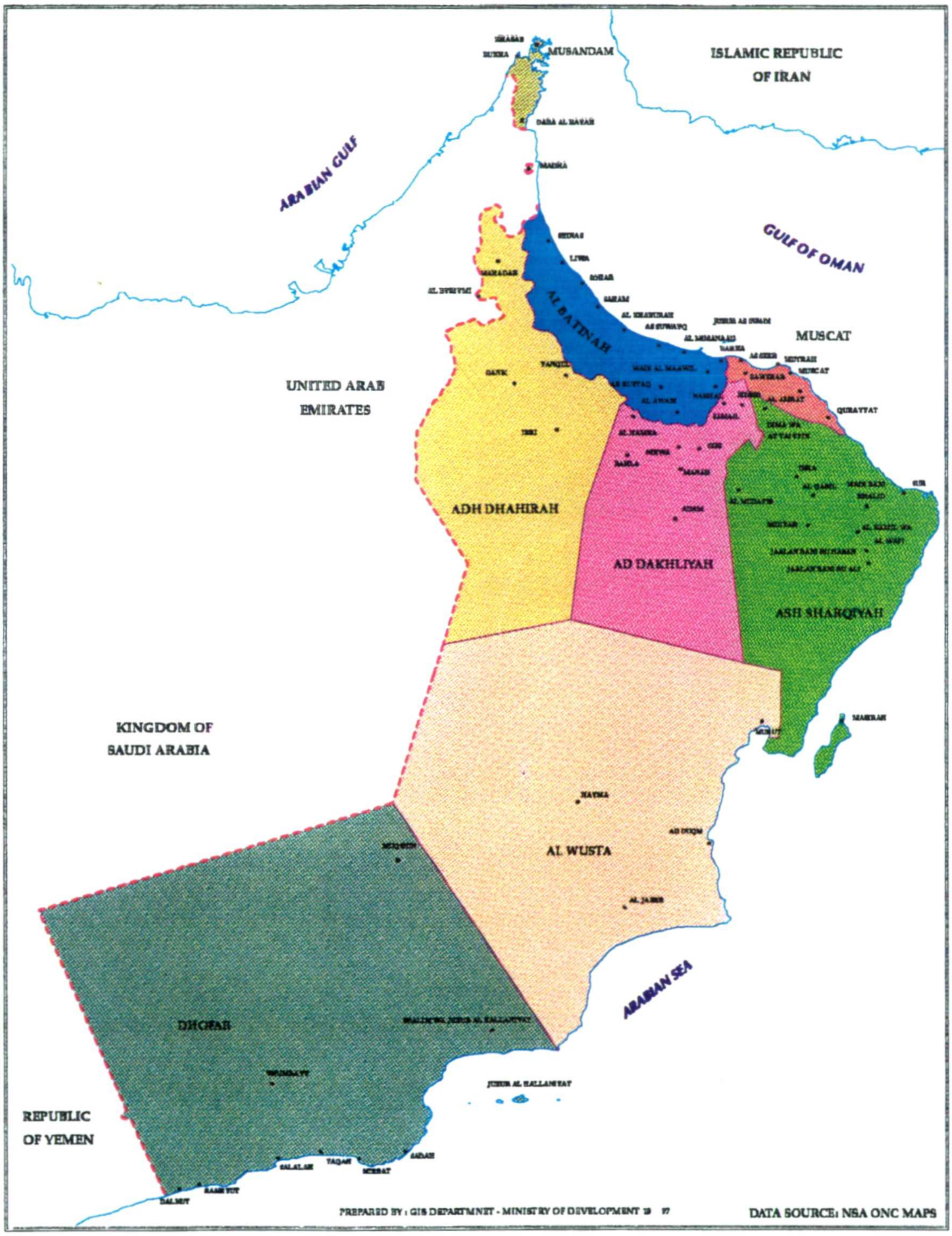
List of Acronyms and Abbreviations

AIP	Autarkic Industrial Policy
bbl	Barrels
B/D	Barrels per day
BO	Build-Operate
BP	British Petroleum
CIP	Competitive Industrial Policy
CIS	Commonwealth of Independent States
cu. ft.	Cubic feet
ECLA	Economic Commission for Latin America
EDI	Economic Development Institute - the World Bank
EGFU	Export Guarantee and Financing Unit
ELF	Elf Aquitaine
EU	European Union
FDI	Foreign Direct Investment
FYP	Five-Year Plan
GATT	General Agreement on Tariffs and Trade
GBP	Great Britain Pound
GCC	Gulf Co-operation Council
GCF	Gross Capital Formation
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GNP	Gross National Product.
GNVQs	General National Vocational Qualifications
HDI	Human Development Index
HDR	Human Development Report
HRD	Human Resource Development
ICP	International Comparison Programme

IFIs	International Financial Institutions, most notably The World Bank and the International Monetary Fund.
ILO	International Labour Organisation
IMF	International Monetary Fund
ISI	Import Substituting Industrialisation
ISIC	International Standard Industrial Classification
IUCN	International Union for Conservation of Nature (now World Conservation Union)
JAPEX	Japan Petroleum Exploration Co.
LDCs	Less Developed Countries
LLC	Limited Liability Company
LNG	Liquefied Natural Gas
MENA	Middle East and North Africa
MITI	Ministry of International Trade and Industry (Japan)
MNCs	Multinational Corporations
MOD	Ministry of Development (Sultanate of Oman)
MOEW	Ministry of Electricity & Water (Sultanate of Oman)
MSM	Muscat Securities Market (Sultanate of Oman)
NGOs	Non Government Organisations
NICs	Newly Industrialising Countries (Hong Kong, Singapore, Taiwan and South Korea)
NIEO	New International Economic Order
NNP	Net National Product
NVQs	National Vocational Qualifications
OCIPED	Omani Centre for Investment Promotion and Export Development
ODB	Oman Development Bank
OECD	Organisation for Economic Co-operation and Development
OPEC	Organisation of Petroleum Exporting Countries
OXY	Occidental Group

PAMAP	Public Authority for Marketing of Agriculture Produce (Sultanate of Oman)
PDO	Petroleum Development (Oman) Ltd.
POE	Privately Owned Enterprises
PPP	Purchasing Power Parity
R & D	Research and Development
RBI	Resource-based Industrialisation
RER	Real Exchange Rate
SAPs	Structural Adjustment Programmes
SERF	Sate Emergency Reserve Fund
SGRF	State General Reserve Fund
SNA	Systems of National Accounts
SOC	Social Overhead Capital
SOE	State-Owned-Enterprises
TRIPs	Trade Related Intellectual Property Rights
UK	United Kingdom
UAE	United Arab Emirates
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme.
UNESCO	United Nations Educational, Scientific and Cultural Organisation
UNICEF	United Nations Children's Fund
UNRISD	United Nation Research Institute for Social Development
USA	United States of America
WDR	World Development Report
WIDER	World Institute for Development Economics Research
WTO	World Trade Organisation
(-)	Data not available

SULTANATE OF OMAN



INTRODUCTION

1. Background

In the post-World War II era, the consensus in the newly formed discipline of development economics[1] was that promotion of development could not be left to markets; planned state intervention was considered an indispensable condition for development in less developed countries. However, since the mid-1970s the pendulum has swung towards the opposite view; the state is now considered the problem, rather than a source of solutions, and the free market is regarded as a panacea for the problems of development. Prosperity, it suggests, is best secured by free markets.

The significance of this state versus market debate, in the area of economic and social development has a bearing on the on-going controversy about the success or failure of the Structural Adjustment Programmes (SAPs) and market-oriented reforms which are being carried out by a number of developing countries under the auspices and supervision of international financial institutions such as the World Bank and the International Monetary Fund (IMF). Equally relevant for formulating an appropriate mix of policies are the issues emerging from this debate that should inform and shape the development process in the next century.

In view of these changed perspectives on development strategies and problems, and keeping in view the part hitherto played by the state in developing economies, it is necessary to re-examine the roles of state and markets in economic and social development without being dogmatic in extolling the virtues of one and denouncing the other.

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[1] Development economics was itself to be considered later as inadequate to comprehend problems of development; a more interdisciplinary approach emerged culminating in *development studies*.

In the case of Oman the issues involved in this debate are important because in contrast with many other developing countries which have relinquished or substantially diluted development planning from the late 1970s, Oman has actually embarked upon state-led developmental planning since 1976. Even now Oman's development hinges upon state-sponsored five-year development plans. The question therefore is: what are the implications of the state-versus market debate for Oman? And *ipso facto* for other developing countries. Do they indicate that in Oman the state should - in view of the results achieved and lessons learnt — roll back and allow its development functions to be performed by the market? Or should the state in Oman redefine its role within the tradition of indicative planning and serve only as a guardian of the economy by providing strategic guidance and let the market play an increasingly large role in resource allocation and development? These are some of the key issues which form the basis of the thesis.

2. Objectives of the Thesis

This thesis provides a theoretically grounded, empirical analysis of Oman's development experience in the context of issues involved in the state versus market debate. The period covered by our analysis is from 1970 to 1995 and more specifically from 1976 onwards, when the First Five-Year Plan (FYP) was launched. The analysis is comparative in the sense that the achievements and problems of Oman's economic and social development are, wherever relevant, compared with the development performance of other similarly placed developing countries.

With the objective of providing an analysis of Oman's development performance the thesis focuses on investigating the following issues:

i) the systematic use made by the state in Oman of the five-year plans and the market mechanism via the growing private sector for implementing the multiple objectives of its development policy;

ii) the policies followed by the Omani government for effective utilisation of the oil revenues in maintaining macro-economic stability and, at the same time, promoting socio-economic transformation;

iii) the changing importance of oil as compared to other sectors of the economy; and

iv) the new development strategy introduced in the current Fifth FYP (1996-2000) to overcome a number of obstacles and challenges that Oman faces in achieving sustainable development, and the four pillars of this new strategy, viz. (a) fostering a diversified and dynamic economy; (b) promoting an efficient and competitive private sector; (c) accelerating development of Omani human resources; and (d) sustaining and enhancing macroeconomic stability.

As already stated this thesis intends to provide theoretically grounded empirical analysis of Oman's development experience. Hence, in this regard, it examines critically (a) the various theories of development — from the mainstream, structuralist and radical schools of development thought and also the theories dealing specifically with primary exporting countries; and (b) the implications of the recent resurgence of neo-classical economics — the so called counter-revolution — for development theory and policy.

Both state-sponsored planning and the market have played an important role in Oman's development. The thesis is thus also concerned with analysing the theoretical underpinnings and policy implications of the on-going debate on the role of market and planning in developing economies. The issues involved in this debate are evaluated in the context of international policy and the global economy.

In this context, the thesis provides a critical assessment of 'market-friendly', 'minimal-state' approach to development policy advocated by the World Bank and supported by neo-classical economists. This assessment is carried out by briefly examining the socio-economic aspects of the SAPs carried out by a number of developing countries, in addition to investigating the importance of state intervention in the high performance of the East Asian economies[1] (including Japan). A brief empirical analysis of the way planning has worked in practice in four selected countries, China, India, South Korea and Japan, in addition to Oman, is also provided.

In relation to the oil-export dependent economy of Oman, the thesis analyses the complementary roles of the government and the private sector in promoting diversification of the economy and development of indigenous human resources to reduce dependence upon oil exports and an expatriate labour force. Since privatisation of State-Owned Enterprises (SOEs) is a crucial issue in the state versus market debate, the thesis examines the various issues involved in the privatisation process in the light of the experience of Oman and other countries.

3. Main Conclusion of the Thesis

The main conclusions of this research is that in a short period of twenty-five years (1970-1995) Oman has achieved considerable economic growth, social development and macroeconomic stability. This is especially so when one bears in mind the fact that until as late as 1970, Oman was a poor country suffering from prolonged economic stagnation and political isolation. It lacked the basic elements of development such as paved roads, electricity, telephones, health and education facilities, safe drinking water, housing and employment opportunities. Oman's achievements in terms of per capita income growth; control over rate of inflation; trends in primary and female education; life expectancy; infant mortality and supply of safe drinking water, compare very favourably with other

[1] These are the so called 'four tigers', South Korea, Taiwan, Hong Kong and Singapore (World Bank, 1993b).

similarly placed developing countries. This was achieved by the state allocating public investment through a series of FYPs[1] and actively encouraging private investment, i.e. through a combination of planning and the market.

The main factor which contributed to these achievements was the investing of a sizeable proportion of economic rents generated from oil in the establishment of economic and social infrastructure through allocation of public investment. It was through development planning that Oman could implement such rational allocation of public revenues and public expenditure, in accordance with predetermined priorities, within the framework of a long-term development strategy.

Oman could control inflation and maintain exchange rate stability largely because of (i) its free trade policy, and (ii) the mechanism established through the setting up of State General Reserve Fund[2] (SGRF) to deal with oil price volatility. This involved transferring a portion of government gross oil revenues to the Fund in times of high oil prices and resorting to the Fund when there was a need to finance fiscal deficits. This fund was thus used to counter the adverse effects of Dutch disease[3] syndrome faced by oil exporting countries in times of booming oil exports.

Oman's industrial policy was based on the principles of promoting the growth of private industry in a competitive environment, with minimum protection. SOEs were set up only where private capital was not forthcoming or in case of "natural monopolies"[4], where competition was impracticable or undesirable. Oman has been able through development planning and encouragement of the growth of the private sector, to augment substantially the relative share of the non-oil sector in the gross domestic product, even as

[1] Between 1976 and 1995 Oman had executed four five-year plans. Currently the Fifth FYP (1996-2000) is under implementation.
[2] The State General Reserve Fund established in 1980 has been the main reserve fund (Oman, 1981a:pp.243-246). Chapter IV and V provide further details on this and other funds instituted for this purpose.
[3] This is discussed in Chapter II of this thesis.
[4] These are public utilities such as water, electricity, gas and telecommunication.

the latter has increased significantly over the last two decades. However, within the non-oil sector, it is the services sector which accounts for the predominant share and the relative shares of industry and agriculture, though growing, are quite small. This presents one of the main challenges, as we shall see in subsequent chapters.

In the last decade, Oman has experienced declining trends in savings and investment rates mainly because of a falling rate of public savings and investment, stagnation in private savings and investment and a rapid rise in the outflow of expatriate workers' remittances. In recent years, the government's fiscal deficits have also become increasingly large because of unchecked growth in current expenditure and sluggishness of net oil revenues. Large withdrawals from the SGRF for financing the growing fiscal deficits have reduced considerably the resources of the fund while the progressively increasing workers' outward remittances have been the main reason for the rising trend in external current account deficits.

The state has continued to play a pre-dominant role in Oman's social and economic development. However, the state has not assumed this role by suppressing market forces or restricting expansion of private sector activities. In fact, in Oman, the long-term development policy is committed to maintaining a free market mechanism and expanding the scale and scope of private sector activities. To achieve these objectives the government provides concessionary long-term loans and equity participation either directly or through specialised development banks which have been set up for this purpose. No taxes are levied on exports, while a certain level of tariff protection is provided to infant industries. In addition, the government has established a comprehensive regulatory framework, capital market institutions and modern industrial estates to promote private sector activity. Thus the roles of the state and the market in Oman are not conflicting but complementary, and these two institutions have so far worked in tandem, with the result that their contributions to the development process in Oman have been synergetic and not mutually exclusive.

Our analysis of development theories suggests that different schools of development thought connote different interpretations of economic development. An examination of the concepts underlying these theories leads to the conclusion that development is a multi-dimensional process entailing simultaneous achievement of multiple goals, such as: sustained per capita income growth, equitable distribution; provision of basic needs to all; enhancement of people's entitlements and capabilities, and environmental sustainability. The market has played — and continues to play — a supporting and complementary role, but development planning has been and continues to be necessary for achieving the twin objectives of growth and human development.

Our discussion of the importance of state intervention in the East Asian economies, the salutary effects of market reform in China and India and our analysis of Oman's record in combining the strengths of planning and market mechanism leads us to conclude that contrary to the neo-classical viewpoint advocated by the World Bank, the case for 'rolling back the state' is rather weak. Our thesis cautions against the universal adoption of the market-oriented policy reforms prescribed by the World Bank and the IMF under the SAPs. Keeping in view the development experience of these countries, the conclusion of our research favours an active role of the state in spheres of human resource development, diversification of the economy, and private sector development. It must be stated at the outset that the aim of this thesis is neither to laud and shower uncritical praise on Oman's development nor to adopt an air of false modesty in so far as Oman's development is concerned. Our aim is to be objective.

The next phase of Oman's development, beginning with the Fifth FYP, formulated according to Oman's new long-term development strategy[1] is both difficult and crucial for its future prosperity. The objectives set in this strategy are likely to be more difficult to achieve than those attained since 1976, when Oman began its economic planning. This is not to suggest that the process of development has been easy or has been entirely successful in attaining the stated objectives. On the contrary, there have been difficulties

[1] This new strategy is described as 'Vision : 2020'.

and failures. For example, as we will discuss in subsequent chapters, Oman's performance in diversification and industrialisation has been less than satisfactory. And unless the economy becomes less dependent on oil, it could face serious dislocation — when this resource is depleted by the year 2020.

4. Previous Studies on Oman's Development

The review of literature below is not aimed at providing a detailed analysis of each text, which is not necessary for our purpose. The aim rather is to situate the existing state of scholarship (its strengths and weaknesses) on Oman's development, and the way our research points to a new departure, and original synthesis, for analysing that process in the Sultanate.

Oman is one of the least researched countries, particularly in the area of economic and social development. Our study is one of a few, if not the only, theoretically based empirical study of the economic and social transformation of the country covering the period 1970-95. Our study approaches this problem by locating Oman's principal instruments of development — its development policy and plans, within a comparative, theoretical and international policy perspective.

In contrast, most books and articles on Oman tend to deal with the economy, society, culture, history and politics of the country either by separating the subjects or they tend to be informative but journalistic and descriptive in their orientation.

Another shortcoming of works on Oman is that Oman's economic and social development is studied as if Oman were a self-contained entity with little systematic connection to the rest of the world, except where changes in the price of oil affect its exchequer. In other words, analyses are also lacking of Oman's economic and social transformation within the context of the global policy and economy, (price of oil, terms of trade, the World Bank, the IMF, globalisation), and within a comparative framework (development experience of other countries), together with consideration of the major instruments and strategies adopted by these countries and Oman.

In fact one study on Oman states that "[T]here has been only a very limited list of scholarly publications about Oman in books and journals" (Skeet, 1992:p.xii). It is however, possible for our purpose, to discern two categories of scholarship on Oman[1].

In the first category there are books and articles which provide descriptive accounts of Oman's economic and social development. These lack any theoretical framework or explanatory schemata, and are thus limited in their analytical value. Different levels of abstraction and concreteness remain unconnected, as we shall see below. Moreover, since the period covered by these works does not extend to 1995, they do not carry any discussion of Oman's new development strategy.

The second category of scholarship tends to be theoretically rather narrow, technical and highly specialised in one or two aspects of Oman's development. These approaches lack a macro and intersectoral (multi-dimensional) perspective on Oman's development, and are thus limited in their analytical value in so far as an *understanding of the transformation and development of Oman's economic and social structures are concerned.*

The fact that Townsend's (1977) work published twenty years ago is reviewed in our research which is being completed in 1997, shows the sad lack of scholarship on Oman. This book, like Skeet's, represents standard scholarship on the political economy of Oman, with sections on the development of the state, the economy and society, and so on.

Written by an 'insider' in the sense that the author was the Economic Advisor to the Omani Government during the years 1972 to 1975 when the new ruler, Sultan

[1] Works on Oman reviewed in this section are arranged according to the year of their publication.

Qaboos, had just embarked upon his modernisation programme, the book mainly covers the period 1970 to 1976. It is divided into three parts, of which the first deals with the historical background for the period 1932 to 1970. Apart from a brief chapter on the economic geography of Oman, giving brief details of climate, crops, population and oil production (1966-75), the rest of this part deals with political history of the pre-1970 period.

In this connection the author states the problem of economic development in Oman in the following manner:

> [T]he possibility of the destruction or impoverishment of Oman's natural water resources, coupled with probable early exhaustion of the country's crude oil reserves, means that there are very severe constraints both to economic development and to political independence (Townsend, 1977:p.22).

Townsend's analysis of Oman's development constraints, which points to an ecological (water) and resource (oil) reductionism is seriously flawed. There is a lack of systematic analysis of theory or policy which may constrain or facilitate development in Oman, thus transcending a reductionist argument. Moreover, there is no attempt in Townsend's work to locate Oman's development within the operations of the international economy or to refer to and learn from (however problematically) the development experience of other countries, including the Newly Industrialised Countries (NICs), which secured development in spite of a poor resource base. State policy and the international political economy, rather than resources, were crucial in their development (Wade, 1990), as we shall see in later chapters.

The Second Part of the book which is devoted to the emergence of the 'new order' under Sultan Qaboos, provides detailed discussions of the accession of Sultan Qaboos, the nature of insurgency in Dhofar, the making of the new government, the beginning of development programmes and the involvement of the World Bank assistance in this task. This part also highlights the support for state-led development that was given in those days by the World Bank. While recommending a technical assistance project for strengthening the planning mechanism in Oman, the 1974 World Bank Report stated:

> The proposed technical assistance project is an essential first step in Oman's development ... The assistance for *economic planning* would help devise the general framework and strategy for development ... Now that the Government has succeeded in stimulating economic growth, it recognises the need to administer the development, and *guide its future* direction (Townsend, 1977:p.156) (emphasis added by the present author).

Part Three of the book deals with the style of functioning of the new government under Sultan Qaboos, the problems of expanding modern education in a traditional, religious society, and the challenges that would come up in the process of rapid development. The last chapter briefly deals with Oman and its neighbours in the Arab World.

From this short summary of the book, it is clear that its subject-matter has very little bearing on the analysis of the economic growth and human development of Oman from 1976 to 1995 which is the major concern of our thesis. Moreover, while the overall tone of the book is one of great pessimism about the future development of Oman, one can argue that the justification for state-led development planning lies in its findings. For, as we shall see in Chapters IV, V and VI, it was through a systematic implementation of a series of five-year development plans that Oman has been successful in overcoming the institutional, financial and economic problems that Townsend argued might bring down the government of Sultan Qaboos.

Clements' (1980) work describes the rebirth of the ancient land of Oman as a modern nation in 1970 with the accession of its present ruler, Sultan Qaboos bin Said following a bloodless coup in July, 1970. The book's purpose is to discuss various aspects of the "renaissance" ushered in under the reign of Sultan Qaboos and the problems that Oman faced during the first decade (1970-79) of this renaissance.

Clements emphasises that in terms of its people, society and culture, Oman differs significantly from the rest of Arabian Peninsula, particularly in terms of the multireligious[1], multicultural and liberal aspects of Omani society. An important observation Clements makes is that "Omani society is a paternal one and indeed if one is to understand its structure and the role of the Sultan this has to be appreciated because the Sultan is regarded very much as the father of his people" (p.18).

Clements suggests that Oman's well being in the future rests on two main factors: educational development and providing for the needs of the young people, and on the development of agriculture and fisheries. With regard to education he analyses the qualitative aspects of educational development such as the structure and curricula of school education, its planning and administration and the significance of peoples' enthusiasm without which the rapid expansion of education could not have taken place.

Clements also stresses that though the development of oil and gas has made a major contribution to Oman's present prosperity, the future economic base of Oman will consist of agriculture and fishery. He argues that oil and gas are finite resources whereas land and sea, if carefully developed and husbanded, are infinite resources. This is a very plausible argument, for it does make sense to develop and rely on sustainable and relatively abundant resources. We discuss the allocation of resources to agriculture and fisheries in the chapters that follow, but particularly in Chapters V, VI and VII and within the context of diversification strategies in Oman.

[1] That is, groups following different sects of Islam and groups belonging to different religions (Muslims, Hindus and Christians).

Clements' work like that of Townsend, does not discuss Oman's political, economic and social developments during the period 1970-1979 in the context of any explanatory theoretical framework. In contrast, our analyses of Oman's economic and social development engages with both development theory and the theoretical issues surrounding the role of the state and market in development.

Pridham's (1987) work contains 13 papers, only four of which deal with the social and economic development of Oman.

The paper on "Updating Agricultural and Associated Rural Enterprises" by Dutton discusses the transition of Oman's rural sector from the pre-1970 to post 1970 period. This paper brings out the importance of the unique falaj system of groundwater irrigation in Oman's rural economy and the conservation measures required to sustain it. The measures taken by the government in relation to agricultural research and extension are also discussed in this paper. The scope of this however is limited in that it does not place development of agriculture within the perspective of overall economic development and diversification of the non-oil sector.

"Oman's Development Strategy" by Whelan is mainly descriptive and informative. It deals with economic development achieved in Oman during the period 1970 to 1984. Therefore, the problems experienced by Oman during the period of declining oil prices, i.e. from 1985 onwards, are not discussed in this paper. Moreover, the specific aspects of development strategy and achievements are described only briefly with the necessary statistics.

Birks and Sinclair's paper on "Successful Education and Human Resource Development" provides useful information up to the period 1983-84 on aspects of development in which Oman has made significant gains. The paper also provides interesting analysis of the main schemes and programmes in relation to education, training and public health care systems in Oman.

The paper by Hughes[1] on "Oil in Oman — A Short Historical Note" provides a brief history of the exploration and production of oil in Oman from the 1920s. It describes the process of the formation of the largest oil company viz. Petroleum Development Oman (PDO) and the main features of the partnership agreement between the Omani government and foreign companies. The history of the oil sector presented here stops at 1985.

Compared to the topics covered in the papers included in Pridham's work, our thesis is much more specific because it deals with policy and planning and is also more comprehensive in content. Our analysis discusses the period up to 1995 but also analyses future strategies in light of the past and future trends in the development of Oman's economy (both macro and sectoral) but within the overall long-term development strategy.

Kalmoor's (1988) work is academically rigorous but its scope is limited to examining the way financial processes contribute (indirectly) to development in Oman. Among the issues that Kalmoor addresses are: the qualitative and quantitative relationship between the real rate of interest on deposits and private saving and consumption; the role of real interest rate in private investment, and so on (*ibid.*:p.88).

The methodology adopted is that of constructing (a) a macroeconomic model reflecting the structure of Oman's economy and (b) a complete (economy-wide) model.

Kalmoor's analysis is often abstract and couched in mathematical language, avoiding identification of Oman's political, economic and social structures in which financial processes take shape, and in turn, condition these processes and structures.

Whilst Kalmoor's work is a significant piece of research applying modern macroeconomic theory to evaluate a country's economic policies, its scope is nevertheless

[1] Francis Hughes was the General Manager in the late 1960s and early 1970s of the only oil producing company then — Petroleum Development (Oman) Ltd.

limited since it deals mainly with the fiscal and monetary policies of Oman and that too only from 1977 to 1985.

Speece's (1989) work provides an historical analyses of Oman's traditional, historical duality of two distinct spatial structures of the coast and the interior which prevailed in pre-1930, i.e. in pre-oil Oman. The coastal trading towns with international marketing networks were characterised by a dendritic spatial system based on rent capitalism. That is, a system in which the trading merchants — many of them foreigners — as owners of capital acquired economic interests in land and agriculture in the interior through their trading and money lending activities and appropriated surplus from agriculture in form of rent. These merchants were rentier capitalists and absentee landlords, but they did reinvest part of their rental surplus in land through improving or creating irrigation systems, etc. In the interior, agriculture and manufactured goods were traded through the bazaar systems with links extended to coastal merchants. The land tenure system in the interior was such that small, owner-cultivated subsistence holdings existed side by side with large farms owned by absentee landowners residing in the coastal towns.

Speece argues that this duality between coast and interior has not disappeared completely with the emergence of the oil sector as the dominant sector of the economy.

Of course this duality has remained even after the emergence of oil as the primary resource. However, as we shall see in Chapters IV and V, Omani development plans have given particular attention to overcoming the economic and spatial duality prevailing in Oman in 1970 by allocating resources and economic activity to the regions. It is most likely that in the absence of such planned allocations the duality analysed by Speece might have been exacerbated further after the expansion of oil revenues.

Skeet's (1992) work belongs to the first of the above two categories of works on Oman. It may be considered standard genre of the political economy of Oman. It is descriptive and informative, but rather journalistic in its orientation. There is a brief historical account of the emergence of modern Oman and the factors that facilitated this process. The main focus is on the post 1970 changes.

The section on Economy and Infrastructure in Part Two of the book is most relevant for us. This section, which comprises sub-sections on oil, finance, investment, education and health and telecommunications, is informative and presents lucidly the highlights of Oman's performance in growth and human development. A brief descriptive account is given of achievements in the oil sector, development in areas of agriculture and fisheries, small scale industry, Muscat Securities Market (MSM), actual and planned allocation of investment under the first two five-year plans, expenditure on and achievements of infrastructural growth and immigrant work-force. The few pages devoted to education and health, provide information about the rapid expansion in education and health care systems. There is also a brief description of the measures planned to achieve balanced regional development and regional distribution of investment under the Third and Fourth FYPs.

Part Three of the book also briefly discusses the challenges that Oman will have to face in the 21st century in the areas of water supply and conservation, diversification of economy and employment generation. It also reviews briefly some of the objectives laid down in the Fourth FYP (1991-1995). These objectives are Omanisation, regional development and the building-up of government financial reserves.

The main weakness of Skeet's text is that it is atheoretical. Each section and sub-section is discrete and unconnected, with an absence of theoretical underpinnings that may explain the empirical processes being described. Thus in describing the aims and objectives of the various five-year plans, one does not find any discussion on the rationale of adopting development planning and its relationship with the market in Oman. Neither is there any discussion on the place of Oman in the international division of labour, which Oman has attempted to turn to its advantage, or in fact to extricate itself from this bind.

There is little in the book which establishes the fact that Oman, like other commodity exporting developing countries, has to negotiate obstacles to development, precisely because of the 'comparative advantage' it has as an oil-exporting economy. In contrast, our thesis is concerned with providing detailed, in-depth, critical appraisal of Oman's performance in the fields of social and economic development up to 1995 — the last year of the Fourth FYP. Moreover, our thesis compares Oman's experience with a number of similar developing countries, and also evaluates Oman's development planning in light of prevailing development theory.

The World Bank's (1994a) document on the *Sultanate of Oman : Sustainable Growth and Economic Diversification*, is a report which examines Oman's longer-term economic prospects, assesses the government's economic policies and provides a package of recommendations for future sustainable growth.

The report indicates that because Oman's oil reserves are not likely to last beyond year 2011, Oman ought to maximise the national saving rate (from its current oil income) and invest the same in foreign assets or domestic projects in such a way that the return from these investments, would be sufficient to sustain consumption standards at current level in the post-2011 period. Considering the declining rate of national saving as the main constraint on Oman's continued economic and social development, the report devotes its remaining chapters (Chapter 3 to 10) to two objectives: (a) formulating a macroeconomic model to estimate the optimal rate of saving for Oman; and (b) suggesting a package of structural reforms to attain the optimal rate of saving.

The reform measures suggested include, *inter alia*, eliminating the public sector deficit and generating a high rate of public saving, allocating a substantial portion of increased public saving to foreign investment to ensure competitive risk-adjusted return on both domestic and foreign assets, establishing separate and effective long-term saving, stabilisation and contingency funds, curtailing the role of government in social and economic services and concentrating government's efforts on the effective fulfilment of its traditional public functions, and so on.

While the assessment rightly identifies a number of development constraints and challenges facing the economy, its recommendations to overcome them are based solely on the neo-classical approach, in the sense that they are biased towards a "pro-market minimal state" viewpoint of Oman's development performance, and their main intention is to drive home the point that the state must "roll back" in Oman. For example, while the report admits the remarkable strides Oman has made in economic, social and political development over the years 1970-1990 through adopting a government-led development strategy, it simply states that reducing the role of the government and expanding the role of the private sector will achieve long-term economic growth, promote diversification and increase economic efficiency. While diversification and human resources development are both given prominence, these are not systematically analysed or placed in the context of overall long-term strategy and linkages with the development process. The World Bank's report also gives a crucial determining role to public finance and the price mechanism.

Our thesis analyses Oman's economic policies without such predilections i.e. we neither assume superiority of market mechanism nor do we intend to propagate the superiority of the state's role in promoting development. In that sense, the viewpoint projected in our thesis about Oman's development performance has a wider scope and perspective, as it includes discussion on the roles of the state, the market and planning in Oman. It also evaluates each policy prescription in the light of contemporary experience and in a way that would increase efficiency without adversely affecting social welfare. With regard to privatisation we show that it would not be an unmixed blessing. Similarly, while principles of sound fiscal management, are important, they cannot by themselves secure economic and social transformation of a developing economy.

Although Chatty's (1996) research is more recent, it needs but a brief mention. This is an anthropological work which traces the history of a development project from conception and design through to implementation and completion. It then assesses the impact of the project on Omani nomads, the *harasiis*, it was intended to benefit. Whilst this is an interesting empirical study of a local entity, it scarcely illuminates the problems of socio-economic transformation of the country within the global context.

The present author's own book (Al Yousef, 1995), *Oil and the Transformation of Oman (1970-95)*, shows the use of oil revenues in securing increased social welfare in Oman, but within the context of fluctuating income derived from the export of a primary commodity. The book is largely empirical and statistical in its orientation and while informative, it does not address the theoretical and empirical processes of development and the role of the plan and market in a systematic manner. Moreover, the data coverage extends only up to 1993.

In comparison with most of the works reviewed above, the scope of our thesis is rather more comprehensive as it covers both the empirical and theoretical aspects of Oman's planning strategies and policies of development. In addition our research makes use of data from 1970 to 1995, i.e. up to the latest year for which official data were available[1] at the time of completion of our research. Importantly our research also analyses some crucial aspects of future development policy adopted after 1995.

The development-related works on Oman reviewed here show a lack of both quality and quantity of research on the country. Thus our research makes a contribution towards reducing that particular shortcoming by providing a systematic analysis of the complexity of the factors involved, including policy, planning and the market, which have determined Oman's economic and social development.

[1] *Statistical Year Book* for 1996 was published in the second half of 1997, i.e. by the time our research was nearing its completion. Moreover, the year 1995 coincides with the last year of the Fourth FYP (1991-95) and hence provides an appropriate milestone for evaluating the outcome of the plan.

5. Methodology and Data Sources

The empirical analysis in this thesis is based on secondary sources. The main secondary sources of information are the official publications of the government of the Sultanate of Oman, and include in particular: (i) the annual *Statistical Year Book* published by the Ministry of Development[1]; (ii) the *Five-Year Plan* issued periodically by the then Technical Secretariat of the Development Council starting with the First FYP issued in 1976, and the current Fifth FYP issued by the Ministry of Development; (iii) the results of the 1993 *General Census of Population, Housing and Establishments* published by the Ministry of Development; (iv) the *Quarterly Statistical Bulletin* issued by the Central Bank of Oman; and (v) internal data of the Ministry of Development, when published statistical information was not available. For data relating to other countries, the main secondary sources are the data published by international organisations which include: (i) the *World Development Report* issued annually by the World Bank; (ii) the new annual *World Development Indicators* issued in 1997 by the World Bank; (iii) the *Human Development Report* issued annually since 1990 by the United Nations Development Programme (UNDP); and (iv) *The Handbook of International Trade and Development Statistics* issued annually by the United Nations Conference on Trade and Development (UNCTAD). With the exception of Oman's Fifth FYP, which is being translated from Arabic into English[2], all publications are in English and are appropriately acknowledged. The theoretical analysis provided in the thesis relates to interpretation and understanding of materials from books and articles published (mostly) in accredited journals. These sources, which are all in English are also duly acknowledged in the bibliography attached to the thesis.

[1] Before the establishment of the Ministry of Development in 1994, vide Royal Decree no. 2/94 issued on 5.1.94 (Oman, 1995c) the Technical Secretariat of the Development Council had been responsible since 1975 for publication of all statistical information.
[2] The English version of the plan was issued in the month of July 1997, however, references in our thesis are based on the Arabic version.

6. Scope and Limitations of the Research

The scope of our research is both broad and limited. It is broad in the sense that the analysis of Oman's development processes and the role of the state and the market in this are located within, and related to, the larger global processes and policies emanating from the developed countries, the World Bank and the IMF. Similarly the development processes of other developing countries are incorporated to give our research a comparative dimension.

Clearly a study that focuses exclusively on Oman or any other developing country as if it were a self-contained entity would be unviable. Especially so in the case of Oman which depends so crucially on the global economy as a market for its oil resources.

Our study is nevertheless limited by the fact that the research is on Oman, and it is not a comparative or a global study. It is also limited by the fact it does not focus in detail on the technical aspects of formulation and implementation of policies and plans. Of course these are very important. But these are taken as given especially since they have been efficiently negotiated. If this were not the case then Oman's development would have been less than successful. Similarly there is little systematic discussion of the processes of the global economy. These are discussed meaningfully in so far as they affect the price of oil, terms of trade, etc. and their consequent impact on the amount of revenues accruing to Oman and hence its disbursible resources for development.

One point of classification is needed: It may be objected that in the chapters dealing with empirical processes in Oman, especially Chapters VI, V, VI and VII, we have made excessive use of statistical material. We have justified the use of statistics because by quantifying Oman's development one gets the true measure of both the problems that confronted the country and the extent to which these were solved — or remain.

7. Organisation of the Thesis

This thesis is divided into eight chapters. Chapter I describes the changing economic scenario in the developing world, and the shifts in development thinking from the state and planning as the significant agent of change to the state as the problem and the market as the panacea in securing development.

Chapter II discusses the major theories of development and the relevance of strategies advocated by some of these theories for understanding Oman's development policy and the implications for the role of state and market in adopting these strategies.

In Chapter III we examine critically the market mechanism and planning in the development process. The reasons which justify the role of development planning in developing mixed economies are also discussed with reference to empirical evidence from a number of developing countries.

Chapter IV analyses Oman's economic and social development during the period 1970 to 1995. After a brief historical background stating the initial conditions of development, the chapter discusses the achievements of Oman in relation to growth of national and per capita income, exports and trade balance, structural change, education, health and development of infrastructures. The chapter also analyses the factors which enabled Oman to achieve its present level of development and examines the constraints on growth experienced in recent years.

In Chapter V we explain the *rationale* for adoption of planning in Oman in the mid-1970s, the objectives of Oman's long-term development strategy and the nature of Oman's planning authority. In respect of each of the four FYPs completed during 1976-95, the chapter discusses medium-term objectives, growth targets and achievements, the planned and actual pattern of investment allocation and an assessment of the implementation of the plan policies.

The objective of Chapter VI is to show that in the development process of Oman the roles played by the state and markets have been complementary and not conflicting. After discussing the basic approach of Oman's policy for combining the strengths of planning and free market mechanism, the chapter examines the developmental functions performed by the state in Oman. The chapter then analyses the policies adopted to encourage private investment, strengthen private sector activities and expand the role of market mechanism. With supportive empirical data the chapter analyses the importance of the private sector in Oman's development and the manner in which the private-public partnership functions in Oman.

In Chapter VII, we review the main problems that constrain Oman's further development and the policies and planning responses formulated to overcome these constraints within the 'Vision 2020' framework. The chapter examines the four 'pillars' of Oman's New Development Strategy viz. diversification, development of private sector, human resource development and macroeconomic stability and shows that achievement of these objectives requires both strategic intervention of the state and the crucial role of the market in Oman's future development.

Chapter VIII summarises the main findings and states briefly the main conclusions of this thesis.

8. Oman's Geopolitics, Economy and Society

8.1 Geography

The Sultanate of Oman lies on the south east corner of the Arabian Peninsula located between latitudes $16^{\circ}40'$ and $26^{\circ}20'$ north and longitudes $51^{\circ}50'$ and $59^{\circ}40'$ east. It occupies a land area of 309,500 sq. km. with a coastline which extends 1,700 kilometres (Oman, 1996c).

Oman has borders with Saudi Arabia and United Arab Emirates (UAE) in the west and with the Republic of Yemen in the south. In the east, Oman faces the Arabian Sea and Gulf of Oman and in the north it overlooks the Strait of Hormuz.

Geographically, Oman is divided into eight administrative regions and 59 wilayats (towns). These are: the Governorate of Muscat which comprises 6 wilayats, including the city of Muscat, the capital of the country; Al Batinah comprises 12 wilayats and occupies the coastal plains between Muscat to the south-east and UAE to the north; Ad Dakhiliyah comprises 8 wilayats and lies in the interior of the country through which the oil and gas pipelines run; Adh Dhahirah comprises 5 wilayats and borders the UAE in the north. It joins the Empty Quarter from the west and Al Wusta region from the south; Ash Sharqiyah comprises 11 wilayats and overlooks the Arabian Sea from the east; Al Wusta is distinguished for having a large part of the oil reserves, it has 4 wilayats and is situated to the south side of both Ad Dakhliyah and Adh Dhahirah regions and at the east side is linked to the Arabian Sea; the Governorate of Dhofar is situated in the far south of the Sultanate, and has 9 wilayats, it borders the Republic of Yemen from the south west; and the eighth is the Governorate of Musandam which lies in the extreme north of the Sultanate, it has 4 wilayats and overlooks the Straits of Hormuz (Oman, 1996b).

Of the vast land area that constitutes Oman, 82 per cent is sand and gravel desert, another 15 per cent is occupied by mountains and the coastal plains represent only 3 per cent of the country (Oman, 1996b).

Muscat is the capital city of Oman. The official language is Arabic but English is widely used in Oman. Currency is Omani Rial (RO) divisible into 1000 Baizas. The exchange rate is pegged to US dollar at the rate of 1 RO = US$ 2.60. Oman — one of the oldest political entities in the Arabian peninsula — has always been at the centre of the regional and international struggle for the control of international trading routes. In the heyday of the Islamic empire, Omani ports were the gateway to Islamic civilisation and dominated the trade with Africa and India. From the late fifteenth century, Oman's strategic location was coveted by the European powers such as the Portuguese, the Dutch, French and British who were eager to control international trade routes (Oman, 1989a).

At present 90 per cent of oil from the Gulf passes through the navigable stretch of the Straits of Hormuz, which is in Omani territorial waters (*ibid.*:p.20).

8.2 Climate

The climate varies from one region to another. In the coastal areas it is hot and humid in the summer, whereas in the Interior it is hot and dry. In the mountainous area the weather is moderate throughout the year.

Rainfall is generally irregular and low, though heavy rains fall at times. The Dhofar region in the south is climatically different due to the Qara mountain range. Here not only is the climate moderate for most parts of the year but, with regular monsoon between June and October, the rainfall is heavy and predictable. Maximum temperature throughout Oman varies between 33^0 to 50^0C during summer, and minimum temperature varies between 4^0 to 17^0C in winter (Oman, 1996b).

8.3 Political system

Oman did not have a modern government machinery until 1970. One of the first tasks accomplished by the present ruler, Sultan Qaboos, soon after he assumed power in July 1970 was to establish a stable government with modern administrative system.

The present Omani political-administrative system is a monarchical government, the executive head of which is the Sultan. The administrative system of the state derives all its powers from the authority conferred on it by the Sultan. This system consists of: the Diwan of Royal Court, the Ministry of Palace office, the Cabinet of Ministers, the

Secretariat of the Cabinet, the Specialised Councils comprising: the Development Council[1], the Financial Affairs Council, the Natural Gas Council[2] and the Majlis Ash'Shura[3] (Oman, 1994b:pp.30-31).

The Cabinet is the highest executive authority deriving its powers from the Sultan to whom it is collectively responsible. All laws, decrees, international treaties, agreements and charters are authorised by the Sultan and come into effect from the date of their publication in Oman's Official Gazette[4].

The Majlis Ash'Shura was established in November 1990 to replace the Majlis Al Istishari, originally established in 1981 and consisting of 35 nominated members, which were subsequently increased to 55 members. Members of the Majlis Ash'Shura are elected, with each wilayat with a population of less than 30,000 Omanis sending one elected member to the Majlis and wilayats having a larger population sending two elected members (*ibid.*:pp.34-35).

The President of the Majlis is appointed by Royal Decree. Among the principal duties of the Majlis is the reviewing of all social and economic laws and participation in the formulation, evaluation and monitoring of the development plan (*ibid.*).

8.4 External relations

Oman has a long history of trade contacts and political relations with many countries in the Arab world, the Indian sub-continent, the Far East and East Africa. Oman was the first Arab nation to establish diplomatic relations with the United States of America (USA) in the first half of 19th century when Oman was ruled by Sayyed Said bin

[1] The Development Council was dissolved during 1996 and its authorities and responsibilities were transferred to the Cabinet vide Royal Decree no. 7/96 (Oman, 1996g).
[2] The Financial Affairs and the Natural Gas Councils were dissolved in 1996, and the Financial Affairs and the Energy Resource Council was set up in their place vide Royal Decree no. 60/96 (Oman, 1996i).
[3] Majlis Ash'Shura is equivalent to a peoples representative body.
[4] Issued twice a month in Arabic language by the Ministry of Legal Affairs.

Sultan of Ya'aruba dynasty. By this time Oman also had treaty relationship with Great Britain and friendly relations with France. However, for about four decades (1932-1970), under the rule of the previous ruler Sultan Said bin Taimur, Oman was completely isolated politically and so when the present ruler His Majesty Sultan Qaboos came to power in 1970 Oman had to win diplomatic recognition from the international community (*ibid.*:p.21).

The Sultanate of Oman joined the Arab League in 1971 and in the same year it was admitted as a member of the United Nations, the IMF, and the World Bank. In the following year Oman became a member of the Islamic Conference Organisation and in 1973 Oman became a member of the Non-Aligned Group of Nations. Oman was a founder-member of the six nation Arab Gulf Co-operation Council (GCC) which was set up in 1981[1] (Kechichian, 1995:pp.55-56).

Oman is also a member of a large number of Gulf, Arab, Islamic and International Organisations. It has diplomatic relations with about 122 countries, and has a large number of bilateral agreements with a number of countries covering social, economic, cultural and political aspects (Oman, 1994b:pp.49-56). It has an access agreement[2] with the USA and has close military and political ties with the United Kingdom (Kechichian, *op. cit.*:pp.89 and 147). Oman has been accorded observer status in the World Trade Organisation and its application for membership of the organisation is being processed. Although Oman's economy is oriented towards oil exports, Oman has never been a member of the Organisation of Petroleum Exporting Countries (OPEC). But Oman has always managed to apply the agreements reached within OPEC, to the extent they were beneficial to Omani interests, in its dealings with the oil multinationals (Al Yousef, 1995:p.30).

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[1] The other members of the GCC are: Bahrain, Kuwait, Qatar, Saudi Arabia and the UAE.

[2] This agreement provides propositioning of supplies and access to a limited number of military facilities on a prior approval basis (*ibid.*).

8.5 Economy

Before the beginning of commercial exploitation and export of oil in 1967, Oman was a typical low-income agricultural country. In 1965, agriculture and fisheries contributed 61 per cent of Gross Domestic Product (GDP), whilst industry contributed 23 per cent of GDP and 16 per cent of GDP was derived from services (World Bank, 1987:p.207). In terms of employment, 62 per cent of the labour force was employed in agriculture in 1965, while industry and services employed 15 per cent and 23 per cent, respectively (*ibid.*:p.265). And in 1960 only 4 per cent of the population lived in urban areas (*ibid.*:p.267).

Oil was discovered in commercial quantities in 1962 and production and exports started in 1967. In 1995, average daily production reached 852,000 barrels, equivalent to an annual production of 311 million barrels, of which 284 million barrels were exported. Although four companies, PDO, Elf Aquitaine (ELF), Occidental Group (OXY) and Japan Petroleum Exploration Company (JAPEX) were producing oil in 1995, about 90 per cent was produced by PDO (Oman, 1996b:pp.185-202).

Approximately 242,266 million standard cu. ft. of gas was produced in 1995, all of which was consumed domestically (*ibid.*).

According to the data obtained from the Ministry of Petroleum and Minerals, estimates of expected oil reserves stood at 5.2 billion barrels at the end of 1996 and gas reserves stood at 17 trillion cu. ft.

In 1995, the oil sector accounted for 38 per cent of nominal GDP, 77 per cent of government revenues and 78 per cent of total export earnings[1] (Oman, 1996b).

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[1] Compiled from *Statistical Year Book 1995* (Oman, 1996b), also see Appendix table 1.

From 1970 onwards Oman has followed a vigorous development policy to bring about rapid socio-economic transformation. In 1976 Oman launched its First FYP and by 1995 Oman had executed four five-year development plans. Currently, the Fifth FYP (1996-2000) is being implemented.

As a result of rapid economic growth, Oman had a Gross National Product (GNP) per capita[1] of US$ 4,820 in 1995, which places it among the Upper-middle-income group of countries (World Bank, 1997b:p.8). In terms of output, agriculture contributed 3 per cent, industry 47 per cent[2] of which petroleum activities accounted for about 38 per cent, and services contributed about 50 per cent of the value-added in 1995 in nominal GDP (Oman, 1996b:p.384). The high priority accorded to education and health care facilities in development planning has resulted in Oman's Human Development Index (HDI) standing at 0.718 in 1994. This places Oman among countries with Medium human development (UNDP, 1997:pp.147 and 165).

The progress attained by Oman in the fields of economic and social development since 1970 is shown by Appendix table 1.

8.6 Historical background

Though very little is known about Oman's pre-Islamic past, archaeological sites dating back to the third millennium B.C. are believed to be contemporary with the region's Berber culture and the great river cultures of Mesopotamia and Mohenjodaro (Oman, 1994b:p.17).

Although trading, farming and fishing settlements existed in Oman as far back as the fourth millennium B.C., there is no evidence of any developed urban civilisation during this early period (*ibid.*:p.18).

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[1] This is according to the World Bank Atlas method.

[2] Industry includes crude oil and gas (38.2 per cent), mining (0.3 per cent), manufacturing (4.6 per cent), electricity and water (0.9 per cent) and construction (2.6 per cent).

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Farming and pastoral communities were flourishing in the mountains when the first Arab people came to Oman from Southern Arabia some 2,000 years ago, and in the foothills to the west and in the deserts nomadic people led their own distinct life. In the highly cultivated Batinah coast lived farmers, fisherman, merchants and sailors who were the people most exposed to the rest of the world by the nature of their trades and geographical location.

It is believed that the first wave of Arab people came to Oman from Southern Arabia some 2,000 years ago. Later, the Azad tribal group, from which the present ruling family has descended, entered Oman from Yemen. Islam came to Oman in 630 A.D. (Oman, 1989a).

From the seventh to the fifteenth century Oman's maritime trade flourished throughout Persia, India, and South East Asia.

In the early 16th century, the Portuguese occupied Muscat for about 150 years but they were expelled by Sultan bin Said Yaarabi in 1650. Thereafter no foreign power has occupied Oman. Under the rule of Sayyid Said bin Sultan, (1807-56) Oman became a major regional power with its borders extending to East Africa with Zanzibar as its second capital. By sending a special envoy to the United States, Oman became the first Arab state to establish diplomatic relations with the USA. By that time, Oman had already concluded agreements and conventions with Great Britain, France, Holland and other countries (Oman, 1994b:p.21).

However, after Sayyid Said's rule ended, Oman remained isolated from the rest of the world for more than a century and stagnated socially and economically until 1970 when the previous ruler Sultan Said bin Taimur abdicated in favour of his son Sultan Qaboos who assumed power on 23rd July, 1970 (*ibid.*).

It can be stated that systematic attempt at socio-political modernisation and economic development of Oman began from the year 1970, when the present ruler, His Majesty Sultan Qaboos bin Said, assumed office as the executive head of the state[1]. The circumstances which forced Sultan Qaboos to take power away from his father arose from the two threats that Oman faced in the late 1960s. The more pressing one was the rebellion in Dhofar region which was about to break up the country. The other threat emanated from the conservative, restrictive social and economic policies of the previous ruler, Sultan Said bin Taimur.

Soon after assuming power, Sultan Qaboos announced his intention of initiating the process of economic development of the country and providing the people with the health care, education and other social amenities they so urgently needed (Oman, 1994b:pp 8-9).

To attain political integration of what was then a divided nation, the Sultan announced on 9th August 1970 that the country would henceforth be known as the "Sultanate of Oman" instead of the old name "Sultanate of Muscat and Oman" (Kechichian, 1995 p.7).

In 1975, after five years of intense military campaign, the armed struggle in Dhofar was brought under control and the south of the country was fully integrated with the rest of the country (Oman, 1994b:p.64).

When Sultan Qaboos took over power in 1970, Oman was different from the other underdeveloped countries of Asia and Africa. Unlike the latter, in the pre-1970 period Oman had not shown any signs of being a 'developing' country. Not having been under

[1] The predecessor and father of Sultan Qaboos. Sultan Said bin Taimur who ruled the Sultanate of Muscat and Oman from 1932 was deposed and abdicated in favour of his son on July 23, 1970 (Oman, 1994b:p.8).

the direct colonial rule of any Western imperialist nation[1], it had been left almost completely untouched by the usual elements of modern civilisation such as railways, asphalt roads, telephone and telegraph, electricity, schools, colleges and universities[2], doctors, hospitals, established civil service, etc. The extent of economic and social stagnation and backwardness of the pre-1970 Oman is clearly indicated by the fact that in 1970 there were only 10 kilometres of asphalt roads, 557 telephone lines, 3 schools with 900 students, 12 hospitals beds, a meagre supply of electricity and water and a per capita income of about US$ 400 (Al Yousef, 1995:pp.22-23).

8.7 Population and society

Oman's population, according to the 1993 census stood at 2,018,074 persons at end of November, 1993, of which 73.5 per cent were Omanis and 26.5 per cent were non-Omanis. In 1996, the population was estimated to be 2,135,000 persons of which 74.7 per cent were Omanis (Oman, 1996c:p.6).

According to the 1993 census results, females formed 52 per cent of the Omani population. About 52 per cent of the Omani population were below 14 years, about 45 per cent were in the age group of 15-64 years and the remaining 3 per cent were above that age (Oman, 1993a:pp.36-37).

About 39.7 per cent of males and 24.7 per cent of females below 19 years of age were unmarried, 56.9 per cent of the males and 61.3 per cent of females in the population were married, and 2.1 per cent of males and 4 per cent of females were divorced, while 1.3 per cent and 10 per cent of each group were widowed. The data from the census also

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[1] Despite the 1798 Treaty of Commerce and Navigation signed with the East India Company, the 1951 Treaty of Friendship, Commerce and Navigation and the 1958 agreement that streamlined military, technical and economic assistance to the Sultanate from the British government, Oman has always remained an independent state. Indeed, Omani independence predated the British presence in the Gulf region (Kechichian, 1995:p.3).

[2] The first university, Sultan Qaboos University started in Muscat only in 1986 (Oman, 1986a).

revealed that 93.2 per cent of total married Omani males had one wife, while only 6.8 per cent had more than one wife at the time of the census (*ibid.*:pp.46-47).

Illiteracy in 1993 was 21 per cent among females in the age group of 15 to 29 years, 82.2 per cent in the age group of 30 to 49 years, and 97.6 per cent in the age group of above 50 years. While the corresponding figures for males were 4.5 per cent, 38.8 per cent and 79.5 per cent, respectively (*ibid.*:p.52).

Because the majority of the Omani population is below the age of 14 years, the rate of economically active population was 37.9 per cent for males. However, for females it was much lower, 15.8 per cent (*ibid.*:pp.52-54). In 1993, 55.7 per cent of the Omani labour force was employed in public administration and defence, 9.9 per cent in health and educational services, 9.3 per cent in agriculture and fisheries and 1.8 per cent in manufacturing. For non-Omanis, the respective percentages were 6.0 per cent, 6.6 per cent, 9.4 per cent, and 13.0 per cent, respectively (*ibid.*:p.59).

According to the Census, about 66 per cent of the Omani people were living in urban areas in 1993, while 34 per cent were living in rural areas[1]. The average size of a household was 8 members (*ibid.*:pp.62-71).

In terms of people's participation in political and social life, the Majlis Ash'Shura referred to earlier is the peoples representative body. In addition, the Omani Chamber of Commerce and Industry which comprises all registered companies in Oman works in close co-operation with the government on all economic and social issues that relate to private sector activities. Also, a number of women's associations have been established with the support of the Ministry of Social Affairs and Labour (Oman, 1994b).

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[1] In the census analysis, any settlement with more than 2,500 persons was considered urban, while all settlements with population below 2,500 were considered rural (*ibid.*:p.11). However, the definition of urban population varies from country to country. Therefore, as per the World Bank estimates, only 18 per cent of the Omani population lived in urban areas in 1995 (World Bank, 1997b:pp.115-117).

Oman is well known for its concern in paying careful attention to environment and heritage. Oman is a member of the International Union for Conservation of Nature (IUCN) and the United Nations Environmental Programme has cited the Sultanate as a country with one of the best records in environmental conservation and pollution control. Moreover, according to the 1982 Law for the Protection of the Environment and the Prevention of Pollution, all industrial or structural projects must get a 'No Environmental Objection' certificate from the Ministry of Regional Municipalities and Environmental Affairs (*ibid.*:pp.56 and 204).

The tribal structure of Oman has undergone deep changes over the centuries. Many nomadic tribes have arrived and sedentarised far from their original territory, while other Bedouin[1] tribes have adapted to changing circumstances and specialised in either farming, fishing or become pastoral nomads (Chatty, 1996:pp.8-12).

At present the Sultanate has a small population of pastoral nomads not exceeding 7 per cent of the total population. The major pastoral tribes in Oman are the Wahiba, the Duru, the Jeneba and the Harasiis. The Wahibas who number about 7000, are mainly engaged in fishing while the Durus engage in camel, goat and sheep husbandry. The Jenebas are pastoral nomads although in the past they had sea-faring interests up to the Gulf, India and to East Africa. They number about 12,000. The Harasiis do not exceed 3,000 and are mainly pastoral nomads (*ibid.*).

The government extends basic social services to the pastoral nomads of the desert areas, without attempting either to settle them or change their traditional way of life. A number of tribal administrative centres and community development centres have been established by the government to provide services to these communities.

[1] The nomadic pastoral tribes of the Arabian peninsula are often referred to as Bedouin (*ibid.*:p.5).

The Sultan issued on 6th November, 1996 the Basic Statute of the State (Oman, 1996k). This Basic Statute lays down the rules and regulations for the State, the system of government and the political, economic, social, cultural and security principles guiding the State's policy. It also lays down the 'public' rights and duties, the authorities and responsibilities of the Head of the State, the government and the specialised councils. In addition, it establishes the methods and procedures for public participation and the independence of the judiciary and the supremacy of the Law.

In terms of social principles, the Basic Statute stipulates that "Justice, equality, and equality of opportunities for Omanis are the pillars of society and are guaranteed by the State" (*ibid.*:p.7). This then is the social, economic, political, ecological, and regional-global level in which we carry out our analysis of the roles of the state and market in Oman's development.

Appendix table 1

Main socio-economic indicators : Oman 1970-1995

Indicator	**Unit**	**Years**	
		1970	**1995**
Population	(000)	658	2,135
Population density	Persons per sq. km.	-	6.9
GDP at current prices	RO Million	104	5,288
GDP per capita (in nominal terms)	RO	158	2,477
Real GNP per capita[1]	US$	-	4,820
Human development index[2]	From 0 to 1	0.598[a]	0.718[c]
Life expectancy at birth	Years	44	67.6
Infant mortality rate	Per 1000 live births	64[b]	20
Public expenditure on health[3]	% of GDP	-	2.4
Per capita expenditure on health services (Ministry of Health only)	RO	4	58
People per physician	Persons	33,333	813
Gross primary enrolment ratio[1]	% of relevant age group	4	85[d]
Public expenditure on education[3]	% of GDP	-	4.8
Per capita expenditure on education (Ministry of Education only)	RO	2	119
Access to safe water[2]	% of population	15[b]	82
Urbanisation[1]	% of population	8[b]	13
Total employment	Persons	32,348	617,648[e]
Public sector	Persons	1,750	103,206
Private sector	Persons	30,598	514,442

Appendix table 1 contd...

Appendix table 1 contd...

Indicator	Unit	Years	
		1970	1995
Merchandise exports[3]	RO Million	88	2,333
Share of oil exports[3]	% of total exports	99.5	78.0
Merchandise imports[3]	RO Million	14	1,684
Share of trade in GDP[3]	% of GDP	98	76
Net barter terms of trade[1]	1987=100	210[b]	77
Share of oil sector in GDP[3]	% of GDP	69	37
Share of (non-oil) manufacturing[3]	% of GDP	-	4.6
Gross domestic investment	% of GDP	14	15
Gross national savings	% of GDP	46	9
GDP implicit deflator[1]	average annual % growth 1990-95	-	-2.9

Notes:

a) Data relates to 1990 and 1994 respectively.

b) Data for 1980.

c) Data for 1994.

d) Data for 1993.

e) Data do not include persons employed by Defence and Security units. Moreover, the data do not reconcile with the 1995 *Statistical Year Book*. Reconciliation is under way.

Sources: Oman (1996c) *Socio-Economic Atlas* for all, except for items stated below:

1) *World Development Indicators 1997*, World Bank (1997b).

2) *Human Development Report 1997*, UNDP (1997).

3) Data for 1970 from *Statistical Year Book 1985* Oman (1986b) and data for 1995 from *Statistical Year Book 1995* (Oman, 1996b).

CHAPTER I

THE STATE VERSUS MARKET DEBATE IN CONTEXT

1.1 Introduction

Most development economists[1] writing in the post World War II era, visualised a dominant role for the state in initiating and sustaining the development process. Developing economies were viewed as being caught in an equilibrium variously described as "vicious circle of poverty", "low-level equilibrium trap", and so on. The problem of development was described as taking the economy out of this equilibrium and setting it on a path of self-sustaining growth. A corollary of this view was the perceived necessity of comprehensive national development planning under state auspices.

However, after almost two decades of state-led development planning and more specifically since the 1970s, state interventions in the economy are seen to harm economic growth and development. State action that goes as far as planning and political control of the economy leads to economic disaster. Privatisation of state owned enterprises and economic liberalisation have been at the forefront of policy in recent efforts to reduce the role of the state and redefine its relationship with the market.

In fact the whole discipline of development economics[2] has come under attack both from neo-classical and liberal economists. As Byres (1994:p.5) notes, "[a] large and growing literature now exists, written by die-hard neo-classical economists, in which the

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[1] These include for example. Rosenstein-Rodan (1943 and 1955); Nurkse (1953); Lewis (1954); Kuznets (1955); Leibenstein (1957) and Hirschman (1958).

[2] Development economics has been defined as the study of the economic structure and behaviour of poor (or less developed) countries (Lewis, 1984a). It is generally agreed that "development" encompasses the reduction of poverty, improvements in the health and education of the population, and an increase in productive capacity as well as rising per capita income (Chenery and Srinivasan, 1988:p.xi). We discuss the evolution of the meaning of development in Chapter II.

apparent absurdities and inefficiencies of planning are identified and the virtues of market solution are proclaimed". The ideal of a free, self-regulating market seems to have triumphed. The economic success of the Newly Industrialised Countries (NICs) of East Asia, especially Taiwan and South Korea, and the collapse of the state socialist political economies of Eastern Europe are used as compelling evidence of the pro-market view point (Balassa and Associates, 1982; Wolf Jr., 1994; World Bank, 1991a).

However, as we shall see there is an alternative view held by other economists and development thinkers who attribute the success of the NICs to the strong role played by the state (Wade, 1990; Singh, 1994) and warn against minimising the role and function of states (Streeten, 1995). This view is supported by our research as we shall see.

As mentioned in the Introduction to the thesis, the significance of the debate on State and Market lies, on the one hand, in the criticism levelled at the extent and style of the role envisaged for the state in the dominant intellectual paradigm in the economics of developing countries over the years 1950-80. On the other hand, it lies in the apparent inability of the structural adjustment programmes (SAPs) to deal with many of the difficulties that transition[1] and developing economies confront a decade after the "neo-classical" or "market-friendly" packages were put together.

This debate is equally important for Oman's future development strategy and policy. Because, as we shall see in Chapters IV-VII, the state in Oman has played and continues to play an important role in promoting socio-economic transformation of the country.

[1] The term 'transition economies' refers to countries with centrally planned economies — in particular, countries in Central and East Europe, the newly independent states of the former Soviet Union, China and Vietnam — which are in transition to market-oriented economies (see World Bank, 1996:p.iii).

There is therefore a renewed need to examine the nature of the state-market dichotomy of neo-classical economics[1], an approach which, as we shall see later, has arguably encouraged a pendulum swing from the former institution to the latter. However, as we shall argue in this and other chapters, it is misleading to view states and markets as mutually exclusive, and it is desirable to examine the strengths and weaknesses of both to see how they can co-operate in fostering development.

In this chapter we shall provide an overview of the main issues relating to the state versus market debate, whilst Chapters II and III will present an assessment of some of the major theories and strategies of development as well as more concrete analysis of issues involved in Plan and Market in the context of development. We first examine the viewpoint favouring a dominant role for the state in development which became prominent in the 1950s and 1960s. We then analyse the criticisms levelled at state-driven development strategy at the end of the 1960s, which resulted in the call for redefinition of development and reconsideration of the state's role. This is followed by a discussion of the factors leading to the resurgence of the neo-classical, pro-market view point. After taking up the question of whether the success of the East Asian economies really lends support to a market-friendly approach, we discuss the consequences of the SAPs and

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[1] The term neo-classical economics is used here to refer to that body of economic theory which uses marginal analysis to show that if allocation of resources and pricing of goods, services and factors of production are left to be decided by freely competitive markets and free trade with the outside world, then consumer welfare would be maximised, resources would be used fully and most efficiently and the economy would grow harmoniously. The founders of neo-classical school were J. M. Clark, I. Fisher, F. Y. Edgeworth, A. Marshall, V. Pareto, L. Walras and K. Wicksell. The primary concern of the neo-classical economics is to analyse the role of market system in allocation of resources and distribution of output. The idea of a perfectly competitive economy is central to neo-classical pricing and distribution theories. This microeconomic approach to describing an economy distinguishes the neo-classicals from the classical economists (Smith, Malthus, Ricardo, etc.) whose main concerns were long run economic growth and its relationship with distribution of economic surplus among different social classes. However, what is common to both these schools of economists is the use of theoretical analysis to show that social welfare and growth of output are maximised when prices are set right through freely operating market system, without state intervention and monopolistic restrictions (Barber,1967:pp.163-165). The term neo-liberals, although it embraces broader political-economy connotations of rents seeking and directly unproductive activities, is used interchangeably in this thesis with the term neo-classical.

market-oriented reforms on issues of human development and trade performance of developing countries. We also examine here the role of the state in Oman's economic and social development and the way the state's intervention has helped to develop the market in the country. We will conclude by attempting to identify a number of areas that can promote co-operation, instead of conflict, between the state and market in development.

Before proceeding to examine the main issues relating to the state versus market debate, first it is necessary to briefly discuss the concepts of the state and market which figure greatly in our analyses of development in Oman.

State and Market : a definition

We use the words 'state' and 'governments' interchangeably in this research. The term government is also used differently in other contexts, but without losing its essential meaning. It can refer to the process of governing — to the exercise of power. It can also refer to the exercise of that power, to a condition of "ordered rule". 'Government' often means the people who fill positions of authority in a state, whereas, the 'state' in its wider sense refers to a set of institutions that *possess* the means of legitimate coercion, exercised over a defined territory and population, referred to as society. Thus the state monopolises rule-making within its territory through the medium of an organised government (World Bank, 1997a:p.20).

A market is the co-ordinating mechanism where the forces of supply and demand in an economy determine prices, output and methods of production via the automatic adjustment of price movements. At the point of market equilibrium, supply and demand balance and no agent can get a better result than the outcome derived from the equilibrium price. Thus under pure and perfect competition there are many sellers and buyers and, if the nature of the commodity is well-defined, the outcome delivered by the market is among the best which can be realised. Conversely, any desired Pareto optimum[1] can be reached by the interplay of markets and transfers via subsidies and taxation (Meier, 1989:p.516; Hayami, 1997:p.199; Boyer and Drache, 1996:p.3).

Put another way the market is an institution[2], that co-ordinates people's activities in seeking self-interest towards increasing social economic welfare. Thus the market is supposed to solve all the economic problems of allocation of scarce resources between alternative methods, and the argument is that a properly functioning market system would tend to stimulate both economic efficiency and economic growth.

The word 'market' connotes other meanings as well. In addition to the market being an institutional mechanism, it is also associated with a precise *locale* and time schedule. Thus a market place is "an authorised public concourse of buyers and sellers of commodities, meeting at a place more or less strictly delimited or defined, at an appointed time" (Boyer and Drache, 1996:pp.96-98).

The classical and neo-classical economists have given an even wider definition of markets. To quote Marshall: "Economists understand by the term of market, not only particular market places in which things are bought and sold, but the whole of any region in which buyers and sellers are in such a free intercourse with one another that the price of the same goods tends to equality, easily and quickly" (Marshall, 1890, as quoted in Boyer and Drache, *op. cit.*).

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[1] Pareto optimality is obtained if any departure from it cannot make anyone better off without making at least one other person worse off (i.e. any departure from optimum can make some one better off only at the expense of someone else's loss of welfare (Pearce, 1992:p.324). Pareto in his work, *Manual of Political Economy* (1906) suggested the following definition: "an allocation of resources in the economy was optimal if there existed no other productively feasible allocation which made all individuals in the economy at least as well-off, and at least one strictly better off, than they were initially" (Eatwell, *et al.*, 1991:p.811). More simply put, the distribution of income or welfare associated with a *laissez-faire* Pareto optimum could be highly unequal (Srinivasan, 1988:pp.3-4).

[2] Douglas North (1994) defined institution as a 'rule in society' and organisation as a functional body or group organised to act for a specific purpose.

We will use the concept of market in terms of both as a place where exchange of commodities takes place, and as a self regulating institutional mechanism involved in production, investment, distribution and consumption of resources.

1.2 The Rise of Development Economics : Triumph of the Pro-state View 1950s-1960s

1.2.1 Development strategies of the 1950s and 1960s

In the post-war years, diverse approaches to development were adopted by developing countries as they struggled to shed the yoke of colonialism and nationalist governments had to decide on an appropriate strategy for development as the social, economic and political structures were all in a state of varying degrees of change[1]. Despite the particular needs and conditions of each of these countries, they shared a distinctive common feature — the growing involvement of the state in managing the process of development.

Rapid socio-economic transformation of society and acceleration of the process of development were the two basic objectives of economic policy in the newly independent less developed countries (LDCs). To achieve these objectives most LDC governments adopted development planning. As Waterston (1982:p.62), states "the national plan appears to have joined the national anthem and the national flag as a symbol of sovereignty and modernity". The developing countries put their faith in planning because, as we shall discuss in Chapter III, in contrast to *laissez-faire*, it meant "rational, deliberate, consistent and co-ordinated economic policy"(Rosenstein-Rodan, 1955:pp.19-22). Thus various

[1] India, for example, was one of the first countries, to stress even before Independence in 1947, the importance of planning in economic and social transformation of the country. This objective is reflected in the Bombay (now called Mumbai) Plan of 1944 formulated by eight prominent industrialists (Byres, 1994:pp.10-11).

forms of centralised planning[1] took precedence over markets for resource allocation in many developing countries.

In fact the World Bank itself became an important agency from about 1950 in encouraging or helping to start organised national development planning in many countries. The growing interest in the LDCs was also reflected in the United Nations resolutions calling for international efforts to strengthen planning capabilities and in the considerable number of international conferences and institutes devoted to economic development of these countries (Waterston, 1982:p.44). Thus the interventionist approach based on development planning was actively supported by international and bilateral agencies which, *inter alia*, encouraged creation of planning machinery and allocated investment funds to public sector projects. A clear statement of this viewpoint is reflected in a 1965 report of a United Nations (UN) Conference on planning, which stated:

> It is an integral task of planning to achieve the best possible use of scarce resources for economic development ... The need for using appropriate criteria for selecting projects arose because of the failure of the market mechanism to provide a proper guideline. In less-developed economies, market prices of such factors of production as labour, capital and foreign exchange deviated substantially from their social opportunity costs and were not, therefore, a correct measure of the relative scarcity or abundance of the factor in question (UN, 1965:p.12).

[1] Because of differences in structure (social, economic and political), and stage of development, the scope of planning at any time can and does range from the limited and piecemeal, project-by project approach found in mixed economies in early phases of development to the comprehensive, centralised planning found in socialised economies. Over time, with changes in a country's stage of development, socialised economies shift gradually towards decentralisation of plan implementation and, for the mixed economies, a movement towards greater centralisation of both plan formulation and implementation (Waterston, 1982:pp.97-98).

It is equally important to note that the early development literature (see Chapter II) greatly influenced development thinking and practice in the two decades following the Second World War[1]. Therefore to achieve economic development the LDCs adopted a variety of strategies, whose main characteristics were:

a) adoption of economic planning to direct both public and private investment;

b) attention was focused on two primary goals, namely, raising the rate of capital formation and promoting rapid growth of real per capita income;

c) import-substitution strategy for promoting industrialisation. Protection of domestic industries against competing imports;

d) reliance upon the 'trickle down' mechanism to spread the benefits of growth to the whole population[2];

e) important role for state-owned enterprises in industrial development;

f) restrictions on foreign direct investment (FDI) and multinational corporations (MNCs) to protect indigenous enterprises from "unequal" competition.

Economic development was therefore conceived as a national goal in the LDCs[3], since it was believed that only increasing prosperity would guarantee viable, independent and democratic societies. Thus the Colombo Plan in 1950, encouraged its member countries of South and South East Asia to formulate six-year development plans based on a realistic assessment of available resources (Waterston, 1982:pp.66-67; Yukawa, 1988:pp.16-30).

[1] The Marshall Plan enunciated by the USA in 1948 as a means for planned/strategic allocation of resources for West European restoration after the Second World War underlines the crucial role of planning in economic thought during this and later decades. Under the Marshall Plan, each participating country was required to prepare comprehensive four-year and annual plans embracing its resources and their utilisation, which became the basis for governmental policy and action (Waterston, 1982:pp.31-32).

[2] This was based on the belief that in the long-run growth would result in higher income for everyone, rich and poor alike, but in the short run emphasis had to be given to increased savings as a requirement for "take-off" (Oman and Wignaraja, 1991:pp.15-16).

[3] The terms LDCs (less developed countries) and developing countries are used interchangeably in the thesis.

Similarly, as the economies of Latin America encountered increasing difficulties towards the end of the 1950s, the need for development planning began to be explored in order to overcome internal as well as external problems. At the Punta del Este Conference in 1961 all Latin American governments accepted that planning should be the fundamental instrument for mobilising national resources, bringing about the necessary structural changes, enhancing efficiency and productivity, and securing more international co-operation. Although national planning was of interest only to technicians until the beginning of the 1960s, with the formulation of the Alliance for Progress it became an essential factor for acquiring foreign aid and consequently a common practice in many Latin American countries. Thus one of the provisions of the *Declaration of Punta del Este* stated: "[E]ach of the countries in Latin America will formulate a comprehensive and well-conceived programme for the development of its economy" (Waterston, *op. cit.*:p.67).

By the mid-1960s almost every African country had a development plan. The basic objective of the national plans of the new nations of Africa was: "[T]o fully realise their economic potentialities not only in order to accelerate the rate of economic growth and improve the level of living of the people but also to recover control over the economy" (Yukawa, *op. cit.*:p.17).

Therefore planning, along with, but sometimes in preference to, the market mechanism, was favoured for a number of reasons. These included the fact that most developing countries lacked the social overhead capital and a number of complementary factors of production and intermediate goods which make private sector development feasible. Therefore, by increasing investment in social overhead capital (SOC), governments would provide the basis for private enterprises to invest in directly productive activities (DPA), as we shall see in Chapter IV in the case of Oman. Also because of the structural rigidities prevailing in developing countries — such as the division of the national economy into two sectors, modern and traditional — the governments had to assume a leading role in generating the fundamental structural transformations that economic development requires. In the case of India, for example, structural backwardness was the main reason for promoting state-led economic development (Chakravarty, 1987:p.9).

Government intervention was also deemed necessary to foster more equitable economic and social development, since it was believed that it would be difficult to achieve these goals even with a well-functioning market. The reduction of inequality between ethnic groups, for instance, has been one of the main objectives of planning in Malaysia (Yukawa, *op. cit.*:p.19).

Added to these arguments was the view emerging from the growth model of Harrod (1948) that capital formation was the driving force of development. Therefore, through a variety of measures which included nationalisation of foreign companies and establishment of new enterprises, the public sector came to be used as a strategic instrument for speeding up the process of development, with the government taking a leading role in capital formation.

This certainly is the case with regard to Oman where the share of the public sector in total capital formation has been significant. As we shall see in Chapter V, the share of public sector investment was around 71 per cent of gross capital formation during the First FYP[1] period (1976-80) but it declined to 65.1 per cent during the Fourth FYP (1991-95). This decline reflected the growing role of the private sector in the country. In Nigeria, for example, public sector investment in total investment was 67.0 per cent in the First Plan (1962-68), 54.8 per cent in the Second Plan (1970-74), 71.9 per cent in the Third Plan (1975-80) and 86.0 per cent in the Fourth Plan (1981-85), (Adeniyi, *et al.*, 1988:p.24). In the case of India it was on average 43.4 per cent during the Fifth Plan (1974/75-1978/79) and about 46.4 per cent during the Sixth Plan (1980/81-1984/85) (Ahluwalia, 1994:p.381).

[1] Sectoral distribution of public and private capital formation is shown in table 5.3 of Chapter V.

For reasons of both ideology and strategy the public sector was seen by governments in developing countries as an important instrument for fostering rapid economic progress and change. Public sector participation was mainly in sectors believed to have significant linkage[1] effects and high positive externalities[2]. Basic industries such as iron and steel, machine tools, chemical, heavy engineering, and large power projects were seen as performing a catalytic function in the early stages of industrialisation by providing essential inputs to other manufacturing and agricultural activities[3].

The dominant view in developing economies from the post-war period to the early 1970s was that markets frequently failed to work efficiently under conditions of underdevelopment because private entrepreneurship and capital markets were inadequately developed and the economic infrastructure required for growth of the secondary and tertiary sectors was lacking. It was therefore felt that the involvement of the public sector, in the key areas of production of inputs and infrastructural services, would make a positive contribution to the cause of development and modernisation.

However, despite the dominance of these views, governments did not supplant the market. Compared to socialist countries where governments had much greater control over savings, investment, output and the structure of prices, the situation in mixed economies was quite different. Japan and South Korea are often cited as examples of successful private-public co-operation. However, as Bhagwati (1988:p.98) puts it, although the state in these countries does not issue proscriptions, it does issue prescriptions. In other words, they intervene by encouraging and promoting selected activities, rather than by prohibiting and restricting.

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[1] Linkages is a term coined by Hirschman (1958). He argued that inducements to invest in the industrial sector could be maximised if economies followed an investment path in which each stage of investment generated, through backward and forward linkages to other branches of the economy, cumulative inducements to invest in these branches also (Hirschman, 1981:pp.63-65).

[2] Externalities arise when there are circumstances in which the action (or inaction) by one party imposes losses on (or yields benefits to) parties or agents external to the transaction (Nove, 1992:p.42).

[3] In the case of India, for example the importance that was attached at that time to the development of a 'machine tool sector' was based on the understanding that an efficient and diversified sector producing machine tools was likely to help substantially the production of capital goods over a wide spectrum of uses (Chakravarty, 1987:p.64).

According to Papanek (1992:pp.131-167), Pakistan and Bangladesh had four distinct periods of state intervention. Two (1949-60 and 1969-77) were characterised by heavy intervention by the government in the economy in the forms of ownership of firms and quantitative controls over the remaining private firms. While during the other two periods (1960-70 and 1978-88) there was heavier reliance on market forces, with no nationalisation of enterprises and greater reliance on price incentives and on indirect forms of intervention or through taxes and subsidies. India's policy has been relatively consistent. In contrast to its socialist rhetoric, subsidies for some producers and consumers and tight control over the economy are accompanied by a *vigorous private sector.*

In Sri Lanka, there were three periods of more *dirigiste*[1] (1950-60, 1961-65 and 1969-77) and two periods of less regulation (1966-70 and 1978-83). While Indonesia had one fundamental shift from a controlled system under President Sukarno to substantial deregulation under President Suharto (*ibid.*).

As Ranis (1992:pp.91-92) argues, the empirical fact is that there seems to exist a tendency, virtually everywhere, even if at different speeds to move toward policies that tend to accommodate rather than replace or obstruct the market.

Therefore, throughout the period of the 1950s and 1960s grand theories and strategies were formulated to guide the development process. As we shall see in Chapter II, development planning[2] was adopted by most developing countries as a means of accelerating the process of economic development through capital accumulation and industrialisation based on import substitution. For a variety of reasons, including lack of entrepreneurship, the importance of economising on scarce capital and skilled labour, and

[1] As compared to the *laissez-faire* approach, the *dirigiste* approach is based upon direct government intervention to promote economic development (Lal, 1985:p.5).
[2] As Waterston states: "[C]ountries were considered to be engaged in development planning if their governments were making a conscious and continuing attempt to increase their rate of economic and social progress and to alter those institutional arrangements which were considered to be obstacles to the achievement of this aim" (Waterston, 1982:p.27).

the desire to bring about rapid social and economic change, the state assumed a major role in economic development activities.

1.2.2 Achievements of the state-driven development strategy

During the first two decades of the post-war period, development economics[1] was inspired by a spirit of optimism which proved to be justified because the policies advocated by development economists and planners led to many important and positive changes in the developing world. Growth of gross national product (GNP) throughout the developing world accelerated, infant mortality decreased considerably, and life expectancy increased significantly; access to education was extended far beyond what could have been imaginable in 1945. The following data from World Development Reports give a more precise idea of the progress made in the developing countries during the period 1950-1980.

[1] During this period development economics held sway over development thought; the latter culminated in the more interdisciplinary subject of development studies which achieved ascendancy in the late 1960s and early 1970s. We will use the terms development thought and development theory to incorporate both development economics and development studies.

Table 1.1

Basic indicators of development performance of developing countries (1950-85)

Description	Years		
1. GNP per capita (1980 dollars)	**1950**	**1960**	**1980**
Middle-income	625	802	1,521
Low-income	164	174	245
2. Growth of per capita GNP (average annual growth rate - %)	**(1950-60)**		**(1960-80)**
Middle-income	2.5	-	3.3
Low-income	0.6	-	1.7
3. Life expectancy (years at birth)	**1950**	**1960**	**1978**
Middle-income	51.9	54.0	61.0
Low-income	35.2	41.9	49.9
4. Infant mortality (per 1000 live births)	**1965**	**1970**[a]	**1985**
Middle-income	104	74	68
Low-income	127	108	72
5. Adult literacy (per cent)	**1950**	**1960**	**1975**
Middle-income	48	54	71
Low-income	22	29	38
6. Primary enrolment (per cent)	**1965**		**1984**
Middle-income	85	-	104
Low-income	74	-	97

Note:

a) Infant mortality data for 1970, from UNDP (1995) *Human Development Report 1995*.

Sources:

1) Items (1), (2), (3) and (5) from World Bank (1981) *World Development Report 1981*, pp.26-27.
2) Items (4) and (6) from World Bank (1987) *World Development Report 1987*.

Table 1.1 shows that the state-led development strategies secured significant improvements in economic and social welfare. For example, in the Low-income developing countries, GNP per capita increased from US$ 164 in 1960 to US$ 245 in 1980 and infant mortality declined during the same period from 127 to 72 per 1000 live births, while in Middle-income countries progress was even better.

Therefore during the first phase of the evolution of development economics covering the first two decades of the post-war period (1950 to 1970), the protagonists of state-driven development strategy dominated both the analytical and policy literature, while the supporters of neo-classical economics were marginalised.

However during the late 1960s and early 1970s, development theory entered a second phase, which focused more directly on poverty and inequality. It was argued that growth in income had not been translated into reduction of unemployment, inequality and poverty in developing countries.

In fact, as we shall see below, the very meaning of development was questioned, and there were calls for redefinition of the meaning and content of development. The World Bank[1] emphasised redistribution with growth, while the International Labour Organisation (ILO, 1976) concentrated on provision of basic human needs.

Both the ILO and the World Bank urged the LDCs to pay more attention to problems of poverty. The concern was part of a wider international process of reformist thinking following the disillusionment that began to set in with 'state-led' development of the 1950s and 1960s.

1.3 Between the State and the Market : the Period of Transition

It is necessary to discuss the paradigmatic shift from state-led to market-led ideology and the strategy imposed by the International Financial Institutions (IFIs) on the developing countries. This exercise is necessary because the neo-classical resurgence

[1] In 1973 McNamara, the then President of the World Bank, in his Nairobi speech placed the weight of the World Bank behind the growing concern at the outcome of policies that focused chiefly on GNP increase while ignoring their distributional implications (McNamara, 1973). Similarly, the study, *Redistribution with Growth* (Chenery, *et al.*, 1974) prepared by a team drawn from the World Bank and the Institute of Development Studies was intended to provide the analytical foundations for a new approach to development analysis and planning.

reproduced neo-classical theory as a self-evident scientific truth, as an axiomatic law of nature constructed on the foundation of questionable facts. It was not at all considered that this theory is ideological and value-laden and serves particular interests, especially those of the developed countries.

The problem under consideration has two aspects. Firstly *how* the neo-classical ideology of the "free-market as good" and the "state as bad" was constructed? And secondly, *why* was this ideology constructed? And whose interests does it serve in spite of pretensions of being neutral or objective? As we shall see the development and articulation of neo-classical thought was constructed on a systematic selection of facts and sometimes their distortion.

As we noted in sub-section 1.2.2 of this chapter, by the late 1960s, the perceptions that the UN Development Decade had failed, that 'growth' had resulted in social dislocation, social and regional inequalities, and that the 'poverty gap' had widened were widespread. There was a growing concern in the 1970s, based on empirical data obtained for a number of developing countries, that the percentage of population living in absolute poverty remained high, with the share of the lowest 40 per cent of the population remaining very low. All this contributed to the growing impression that the 'trickle down' mechanism was not working as it was intended to (Oman and Wignaraja, 1991:pp.97-98 and Hunt, 1989:pp.69-78).

A widely publicised lecture by Seers in 1969 signalled the shift from development as economic growth to a broader concept encompassing reductions in poverty, unemployment, and inequality which became the major themes of the 1970s. The message was clear: Development must no longer be confused with economic growth, otherwise by simple per capita comparison Kuwait is more developed than West Germany or France.

To quote Seers (1969:p.3):

> The questions to ask about a country's development are therefore: What has been happening to poverty? What has been happening to unemployment? What has been happening to inequality? If all three of these have declined from high levels, then beyond doubt this has been a period of development for the country concerned. If one or two of these central problems have been growing worse, especially if all three have, it would be strange to call the result 'development', even if per capita income doubled.

The call for a 'redemption of development' was heard far and wide. As Mahbub Ul Haq of Pakistan asserted:

> The goal of development has to be a determined assault on the worst forms of poverty. Development must aim at the gradual elimination of malnutrition, disease, illiteracy, unemployment and the lack of equal opportunity. We used to be taught that we had to confine our attention to GNP and that this would solve the problem of poverty. Now, however, what we need to do is just the opposite: we have to focus our attention on poverty. It is this which will guarantee the solution to the problems of GNP (Ul Haq, 1976:p.3).

As mentioned earlier in the preceding sub-section, the World Bank too was shaken out of its strait-jacketed approach to development. McNamara in his 1973 Nairobi speech stated that the Bank had decided "to place far greater emphasis on policies and projects which will begin to attack the problems of absolute poverty" (McNamara, 1973:pp.9-10).

Countries such as India followed suit by adopting in its Fourth FYP a Minimum Needs Approach in conjunction with accelerated structural changes for industrialisation.

Meanwhile the reformist's response to the increasing concern with poverty in the 1970s essentially comprised three planks: employment-oriented strategies, redistribution with growth and basic human needs strategies. The climax of this series of diverse yet sharply focused initiatives was the approval by the ILO at its 1976 World Employment Conference of a proposal that national development strategies should place high priority on both the generation of employment and the satisfaction of basic human needs. However, it is important to point out, that in addition to calling for the establishment of a New World Economic Order[1], the conference recognised the need for an increased role for *government planning* and possibly for the *public sector* as well. "[S]tructural changes in such areas as the financial system, land tenure and the education system require direct government intervention. Such policies cannot be implemented simply by influencing market prices" (ILO, 1976:p.53).

It was also in the 1960s and early 1970s that Import-Substituting Industrialisation (ISI) began to come under heavy criticism from neo-classical economists. Among the first to criticise ISI were those writers, e.g., Viner (1953) and Bauer and Yamey (1957), who argued that it interfered with the natural process of economic development based on comparative advantage. Similarly, an OECD research study carried out in the late 1960s, on industrialisation in India, Brazil, Mexico, Taiwan, the Philippines and Pakistan embodied the core of the neo-classical critique of economic policy in developing countries (Little, Scitovsky and Scott, 1970). The policy recommendation put forward by these orthodox critics of ISI clearly reflected the general neo-classical view which stressed *inter alia* the theory of international trade and the concept of 'comparative advantage', together with the importance of relying on the price mechanism in competitive markets, rather than

[1] The United Nations General Assembly in its Sixth Special Session in 1974 adopted a Declaration of *Principles and a Programme of Action on the establishment of a New International Economic Order* (NIEO). The proclaimed goal of the NIEO was to put North-South economic relations on to a basis of 'equality and co-operation' (Toye, 1993:p.179).

administrative controls or planning, to achieve efficiency and maximum growth, (Hunt, 1989:pp.68-69; Oman and Wignaraja, 1991:pp.67-68). Their view was essentially that developing countries should remain producers and exporters of primary products and should encourage the growth of their agricultural and plantation economies.

Despite the neo-classical criticism against ISI, it is important to note, and as we mentioned in section 1.2 of this chapter and as we shall see in Chapter V, in the case of Oman, there were a number of compelling reasons which led almost all developing countries to adopt ISI strategies. In fact, the East Asian economies whose success is attributed to strongly outward-oriented economies (World Bank, 1987), have been successful because their governments have played and continue to play an important role in protecting their domestic markets and promoting their export-led drive (Wade, 1990; Dutt and Kim, 1994).

However, the concerns for a direct attack on poverty, provision of basic needs, and redistribution with growth, which called for state action at the local level and international action at the global level, were overtaken by a number of factors. These included: (a) the debt-crisis of the 1980s which almost forced a number of developing countries to adopt the SAPs prescribed by the IFIs. As we shall see in the following section, the terms on which assistance was provided under the SAPs are underpinned by the neo-classical paradigm; (b) the coming to power of conservative administrations[1] in the industrialised countries, most notably in 1979 in the United Kingdom and in 1981 in the United States, while the rise to power of Gorbachev in the Soviet Union in 1985 was the beginning of the end of the cold war competition of two large blocs headed by the United States and the Soviet Union; and (c) the publication in 1981 of the World Bank report *Accelerated Development in Sub-Saharan Africa* which emphasised the importance of correct pricing policies and reduced government intervention in economic activities as being two of the main elements to a revival in African growth rates (World Bank, 1981).

[1] These were, for example the administrations of Margaret Thatcher (1979-90) and John Major (1990-1997) in the UK and the Republican administrations of Ronald Reagan (1981-89) and George Bush (1989-93) (Toye, 1993:p.207).

Thus the neo-classical philosophy was translated into 'Global Reagonomics', while the NIEO and state-led development strategy were tacitly buried. The developing countries were advised to liberalise their economies, privatise their SOEs, and concentrate on their comparative advantages.

1.4 The Neo-classical Resurgence

The late 1970s and the 1980s witnessed a substantial change in the content of development economics. This was characterised by the resurgence of neo-classical economics. It was the time when privatisation and liberalisation were considered to be indispensable to securing development, with mainstream academic economists, the World Bank, the IMF and policy makers in most countries supporting this view (Dutt, *et al.*, 1994:p.3).

The counter-revolution in development theory and policy (Toye, 1993:pp.44, 70) which has dominated the discourse on development since the 1980s can be understood in part by examining what it was reacting against.

In fact this re-evaluation was dedicated to countering a previous revolution, which was the work of Keynes, and its impact on the economic thought of the 1930s and 1940s. The promise of the counter-revolution in development policy was to solve the problem of inadequate development by neutralising three particular causes: a) the over-extended public sector; b) the over-emphasis on physical capital formation; and c) the proliferation of distorting economic controls.

Whereas Bauer (1972:p.75) in his *Dissent on Development*, argued that the development economics was wrong, politically motivated and corrupt, Lal (1985) in *The Poverty of Development Economics* described it as theoretically wrong and practically unsound: countries following these policies (mainly government intervention, such as central planning and redistribution-with-growth strategies) have had bad economic records compared to those countries (mainly South Korea and Taiwan) which Lal argues followed the neo-classical path. He concluded that "the demise of development economics is likely to be conducive to the health of both the economics and the economies of developing countries" (Lal, 1985:p.109). Lal, of course, is highly critical of the non-neo-classical economists such as Hirschman, Nurkse, Myrdal and so on. In addition to his faith in private enterprise, the clear policy prescription is that of 'getting the prices right' i.e. relying on the price mechanism to promote an efficient allocation of resources.

In addition to the factors mentioned that contributed to the neo-classical resurgence, it was being increasingly argued that the success of the East Asian economies was due to a more limited and balanced role of the state, as well as to the more apt 'market-conforming' economic policies of governments (World Bank, 1993b).

Since we shall be reviewing the neo-classical approaches to development in Chapter II, we will review briefly in this section the neo-classical views on the state and markets and the methods through which these views have been imposed on a number of developing countries. Because the 'market-friendly' approach advocated by the World Bank falls within the neo-classical school, we shall also review this briefly.

1.4.1 The neo-classical views on the state versus market debate

As discussed in sections 1.2 and 1.3, while the early development economists displayed an unquestioning faith in the ability of the state to correct market failures and to effectively direct the economic process towards development goals, the neo-classical economists[1] emphasised "public failures" of regulatory states.

With the renewed emphasis on neo-classical principles, markets, prices and incentives became central (Meier, 1989:p.84). It was argued that markets are collections

[1] These included for example Krueger (1974 and 1978); Balassa and Associates (1982); Little (1982) and Lal (1985). The *World Development Report 1987*, also contains a full review of the studies carried out.

of optimising, self-seeking buyers and sellers who interact with each other in trading goods, services, and factors of production at prices 'determined' by impersonal market conditions. These markets lead to pareto-optimum outcomes as the unintended consequence of individual attempts to maximise profits or utility. The state, on the other hand, is exogenous to the economic process, "it is simply that undefined organisation that solves problems arising in markets" (Dutt, *et al.*, 1994:p.4).

An equally important focus of the neo-classicals criticism is the role envisaged for the state. The style and extent of interventionism favoured by early development economists has been especially criticised, as has their apparent belief that governments would and could intervene in order to improve the incomes and welfare of the poor. The neo-classical economists allege that the slow progress made by developing countries has been caused mainly by excessive intervention in the economy by government.

Trade policy is the core area for neo-classical reform. It is argued by the neo-classicists (Little, Scitovsky and Scott, 1970; Krueger, 1978; Bhagwati, 1978; Balassa and Associates, 1982) that export expansion has been associated with rapid economic growth; countries that have tended to do well in terms of one of these variables have also tended to do well in others. Import-substituting industrialisation which had shaped the development effort of a number of developing countries since the 1950s, was put forward as the primary cause of price 'distortions' and macroeconomic disorders. Thus, according to the mainstream view (Balassa and Associates, 1986; World Bank, 1991a), the Latin American failure is due to internal causes such as excessive government interference and inappropriate government policies such as inefficient import substitution. Therefore, just as import substitution was associated with a large and direct role for government and the public sector, the outward looking approach has been linked to an emphasis on "minimal" government and a strong reliance on the market over all sectors of the economy.

1.4.2 Structural adjustment through pro-market reforms

The concepts of "economic reform" and "structural adjustment", therefore emerged during the 1980s when developing countries were forced to adjust their economic structures to respond to the debt crisis, and to the falling terms of trade[1]. These SAPs were supposed to first stabilise the macro economy and then adjust the market so that it could perform more efficiently.

Stabilisation is the domain of the IMF. Its policy prescription aims to reduce the external deficit (and especially the volume of imports) by cutting aggregate demand. Typical policies include cuts in public spending for both current purposes and capital formation, high interest rates and credit restraints (especially for the public sector). Exchange rate adjustment is the second main component of most of the Fund's packages (Taylor and Pieper, 1996:pp.7-9).

In conjunction with the World Bank package, the Fund usually pushes for liberalisation of foreign trade restrictions, market deregulation (often with an emphasis on curtailing labour power and cutting real wages) and privatisation. The basic aim of the Fund's package is to reduce trade and fiscal deficits (*ibid.*).

Structural adjustment is the speciality of the World Bank and is aimed at improving prospects for medium-term GDP growth. The Bank's main thrust has been to improve the allocative efficiency of the price system. Producer output subsidies and consumer purchase subsidies should be eliminated for all goods. Domestic prices should be driven towards border prices (import or export dollar prices times the exchange rate). Labour market "distortions" should be outlawed. The Bank's views rest on a fundamental theorem of neo-classical welfare economics — referred to earlier — which asserts that a

[1] The heavily indebted developing countries experienced a strong terms-of-trade shock in 1981-83 and, after a brief reversal in 1984, deterioration in their terms of trade continued from 1985 to 1988 (Toye, 1993:p.217). The case was the same in Oman when its terms of trade declined sharply between 1980 and 1986, as we shall see in Chapters IV and V.

fully competitive market will make an economy use its resources optimally[1] and on an average everybody will be as well off as they possibly can be (*ibid.*:pp.10-11).

Other components of the Bank's package include: foreign trade liberalisation, beginning with the replacement of import quotas by tariffs and the subsequent reduction of the tariffs and export subsidies; removal of barriers to external capital flows — such as controls on foreign exchange transactions and profit remittances; and a third target is deregulation of the domestic financial market, the aim of which is to equalise rates of return to different financial assets[2] (*ibid.*).

Privatisation of SOEs[3] also became a major preoccupation of the Bank in the late 1980s. The irony of this is, as Cook and Kirkpatrick (1988) point out, that the international agencies are advocating dismantling of publicly-owned institutions that they themselves created in the 1960s.

Finally, by reducing state intervention and adding "transparency" to the economy, all the above prescriptions are supposed to cut back on unproductive resource diversion due to corruption and seeking "rents", the returns guaranteed from a state-assured market position, such as the possession of an import quota (*ibid.*:p.12).

Under the cross-conditionality restrictions imposed under the SAPs, a country which is not in compliance with the IMF is usually denied access to credits from the World

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[1] Despite its alleged origin from Adam Smith, supply-side economics has little relevance in practice. All governments intervene in setting prices and some of the most interventionist ones, such as Taiwan and South Korea have seen their economies grow the fastest. These issues are discussed in Chapter III of this thesis.

[2] The view in the 1980s was that raising previously "repressed" interest rates would stimulate savings.

[3] As Taylor and Pieper (1996:p.7) state that "It is a phenomenon of a particular time and place, amalgamating long-standing IMF macroeconomic stabilisation policies, the World Bank's self-doubts about its anti-poverty agenda of the 1970s (which led it to try to speed up output growth rates and income "trickle-down" by adopting the market deregulation and supply-side economics ideas in vogue in Washington after the turn of the decade) and London's zeal for privatisation of public enterprises which emerged at about the same time ... [A] synthetic product of the 1980's the consensus appears less and less capable of dealing with many of these difficulties as they persist a decade later".

Bank or to the possibility of rescheduling its official debts and its commercial bank debts (*ibid.*:p.8).

As the contents of the SAPs indicate, a central part of the neo-classical strategy was, of course, to dismantle many institutions, particularly those of the state. "[T]he theory was that changing the structure of incentives would empower market-oriented groups and eventually make them sufficiently strong to enforce new role of behaviour in both state and society to develop new institutions" (UNRISD, 1995:p.49).

However, towards the end of the 1980s, the evident failure of the orthodox neo-classical strategy in both economic and environment terms and particularly the high cost of social upheaval caused by the SAPs (as we shall see in section 1.5) was leading the IFIs to rethink their approach. This confirms Toye's (1993:p.89) analysis that "over-simplified 'solutions', resting on little more than the political perceptions of a distant ideologue, are incapable of resolving the real dilemmas of development satisfactorily". The contribution that arguably has had the greatest impact is the UNICEF's sponsored report *Adjustment with a Human Face* (Cornia, *et al.*, 1987). As a result, the World Bank started to move away from economic idealism and pay more attention to social and political considerations.

1.4.3 The market-friendly approach to development

The World Development Reports for 1991 and 1996 advocate a 'market-friendly' approach to development as against the earlier themes of an almost complete 'rolling back' of the state. The state's role in economic development in this 'market-friendly' approach as set out in the 1991 *World Development Report* (World Bank, 1991a:pp.5-11) is: 'intervene reluctantly' — that is, intervene only in cases where market mechanism would either "fail" or produce perverse results (e.g. public goods, externalities, imperfect markets, poverty relief programmes, education, health, population control and environmental protection); apply checks and balances — that is, put interventions to the discipline of international and domestic markets (competition); intervene openly, — that is, make governmental interventions simple, transparent and subject to rules rather than official discretion; improve the climate for (private) enterprise — that is, provide adequate infrastructure and institutions; and open the domestic economy — that is, apply minimum restrictions on international trade and foreign investment.

The right macroeconomic policy, according to the report, is to keep fiscal deficits at low level, check inflation and provide sufficient incentives for saving and investment. There needs to be more investment in people by targeting government expenditure efficiently on primary education, basic health care, nutrition and family planning.

A superficial reading of these elements of 'market-friendly' strategy makes them quite appealing. And in view of the fact that in many LDCs 'government failure' has done as much, if not more, harm to the cause of development, the appeal of the market-friendly approach requiring 'rolling back', of the state is quite strong.

The market-friendly approach and the underlying neo-classical paradigm are based on the concept of a society where the state and private enterprise are looked upon as adversaries operating on the basis of mutual mistrust. While this may be true in the case of highly individualist societies of the West (for example, British and North American)[1], the same societal norms, values and attitudes are not applicable to many developing societies. For instance, an important reason why state interventions succeeded in East Asian countries is that the state and private business work in tandem, respecting each other as partners interested in achieving common goals. Of course this is not to suggest that the state and private capital relationship benefits all sections of society equally. This may be the result of unintended consequences rather than of deliberate intent.

[1] In fact there is considerable literature which shows the huge gap between the ideology of the free market and actual state intervention of large proportions by US and Europe, e.g. in terms of subsidies, tariffs, etc. (see for example, Streeten, 1995; Toye, 1993).

Secondly, and as we shall discuss in Chapter III and as Toye (1993:p.89) argues, government failure is not just a matter of bureaucratic inertia or empire building, it is the outcome of political manoeuvring by vested interests to frustrate systematically the actions of the organisations that are set up to regulate economic activity in the public interest. The over-spending during the Second and Fourth FYP in Oman, clearly confirms this argument, as we shall discuss in Chapter V.

Thirdly, in many LDCs the scarce supply of entrepreneurship, as much as shortage of capital, has become an obstacle to industrial growth. In the absence of an adequate supply of private entrepreneurs, the state has to play the role of Schumpeterian entrepreneur (Toye, 1993:pp.78-81). Also, evidence relating to large scale enterprises suggests that what ensures efficiency is not ownership *per se*, but the autonomy and professionalisation of management. State enterprises tend to be mismanaged largely due to political interferences. And their unrealistic prices are due to "political populism" and not inherent inefficiency. As we shall see in Chapters V and VI, the role SOEs have played in Oman in "kick starting" the industrialisation process, and their overall efficiency both lead to these conclusions.

Despite these limitations, the World Bank's market-friendly approach and the underlying neo-classical economics have become quite fashionable among policy makers because the remarkable economic performance achieved by Japan, Korea and Taiwan is interpreted as an example of the success of market-friendly approaches. In the following section we discuss how this interpretation of the East Asian miracle is not only superficial but to some extent even incorrect.

1.4.4 The East Asian miracle : the mythology of *laissez-faire* questioned

The free market explanation of East Asian development has been enormously influential in the discussion of development theory and strategy. Indeed, among many economists, it is difficult to think of any contribution that does not locate unfettered enterprise at the core of its explanatory scheme. According to neo-classical economic reasoning[1], the East Asian economies (including Japan) have been successful because their governments have followed 'market-friendly' policies and sought to maximise efficiencies putatively resulting from market-based resource allocation (Balassa and Associates, 1971; Lal, 1985; Krueger, 1980).

However, in the same *World Development Report* in which the World Bank strongly advocated the adoption of market-friendly policies (i.e. 1991 Report) the World Bank also admitted the proactive role of the state in East Asian development. It stated "Selective state intervention has figured prominently in two of the impressive success stories of development; Japan and Republic of Korea. Both countries employed taxes and subsidies, directed credit, restriction on firm entry and exit, and trade protection to encourage domestic industry" (World Bank, 1991a:p.102).

Other studies conducted by Wade (1990); Dutt and Kim (1994); Singh (1994) and even the World Bank (1993a) have seriously questioned the mythology surrounding the East Asian Economies as being *laissez-faire* economies. There is an increasing recognition that "heavily interventionist and protectionist" states have guided the development of the East Asian economies. To quote from the World Bank study, "In most of these economies, in one form or another, the government intervened — systematically and through multiple channels — to foster development, and in some cases the development of specific industries" (World Bank, 1993a:p.5).

Korea's successful performance, for example, is often cited to extol the virtues of free markets and the faults of state intervention (Lal, 1985). However, looking at the recent development experience of Korea, it is very clear that the Korean state was highly

[1] Commenting on the beneficent role of the market in the successful development of East Asian economies, the high-priest of post-war neo-classical economics Milton Friedman stated "Malaysia, Singapore, Korea, Taiwan, Hong Kong and Japan — relying extensively on private markets — are thriving ... by contrast India, Indonesia and Communist China, all relying heavily on Central Planning, have experienced economic stagnation" (Friedman and Friedman, 1980:p.57).

interventionist, and contributed greatly to Korea's success. (Dutt and Kim, 1994:p.209). In fact, both during the inward-oriented phase of (1953-60) and outward-oriented phase of (1961-79), sustained intervention in major economic activities became the rule rather than the exception. The emphasis on import substitution during the first period and the targeting of 'strategic sectors' during the second period was carried out under four five-year plans beginning with the first five-year plan in 1962 (*ibid.*).

Even when a major programme of macroeconomic stabilisation was launched in the early 1980s, in the context of economic liberalisation, to overcome the stagnation and economic downturn of the late 1970s, the basic characteristic of the state was still close to a bureaucratic authoritarian state. "The goals of the state were to be attained at all costs — social and economic" (*ibid.*:p.184).

Similarly, in the case of Taiwan, according to Wade (1990:p.72) evidence shows that the government has been intervening for decades, often aggressively, to alter the trade and industrial profile of the economy in the way that it judges to be desirable. We thus find that the government used its first two four-year plans (1953-1961) to overcome foreign exchange constraint and capital shortage — "the Government should positively undertake to guide and help private investments so that they do not flow into enterprises which have surplus productivity and a stagnant market" (Wade, 1990:p.82). The Third Plan (1961-64) emphasised the need to accelerate the growth of heavy industry. Not only were heavy and chemical industries targeted, but planning documents from the early 1960s picked quite specific products in electrical appliances and electronics.

Again, like Korea, Taiwan's government asserted economic leadership and political control even more strongly than before to carry out a package of reforms to deal with the economic and social problems of the 1970s. For example, the Sixth Plan (1973-76) not only renewed emphasis on export promotion but signalled a strong support for advances in petrochemicals, computer terminals and other such products. The plan also expanded the role of public enterprises, with the result that the public sector's share of investment rose from 28 per cent in the 1960s to about 33 per cent in the 1970s.

In fact, the new Six-year plan[1] of 1976-81 gave an even more prominent role to the state in reducing Taiwan's vulnerability to fluctuations in the prices of key intermediaries — which meant building even more capacity in heavy and chemical industries (Wade, 1990:pp.96-98).

Since the role of the state in the East Asian development is further analysed (with particular reference to Japan and Korea) in Chapter III, we can conclude by way of summary, as Singh (1994:p.57) argues, that contrary to the World Bank's view concerning the role of the state, Japan, South Korea and Taiwan, neither adopted a "market-friendly" approach to development nor sought or practised a deep integration with the world economy during the formative periods of their development. Rather, the state in these countries played a crucial role and followed a highly active development policy. Moreover, these three East Asian economies integrated with the world economy in the direction and extent to which it was useful for the state to do so.

1.5 The Neo-classical Resurgence and its Impact on Development

Since the neo-classical resurgence in development thinking during the 1980s was supposed to achieve what pro-state development strategies had failed to do during the 1950s and 1960s, it is important to examine the consequences arising from neo-classical policies and their associated package of market reforms, which have been undertaken by almost all developing countries during the last 15 years.

It is obvious, and as the evidence produced in UNRISD (1995) report confirms, that the SAPs proposed by the IFIs seem to have been based on a picture of an ideal

[1] The Sixth Four-Year Plan (1973-76) had to be scrapped in the wake of 1973-74 disturbances (Wade, *ibid.*)

country: its economy would be self regulating through open competition, and its public sector would do little more than provide the minimum services necessary for the conduct of private business and the protection of society's weakest members. What they did not take into account was that social damage could itself frustrate economic objectives. As a result, the SAPs have implied hardship, and governments that have used deflationary policies to deal with their economic crises have not been able to come out of recession, while at the same time their people have had to endure the social upheaval caused by radical free-market reorganisation.

Another major negative consequence of the adjustment process has been the weakening of so many state institutions to the extent that they were incapable of making the necessary contribution to ensuring the functioning of adjustment measures. Whereas, as we noted earlier, many developing countries in the 1950s and 1960s, achieved, through state intervention, a level of economic growth and social development far beyond what would have been imaginable in 1945, even if the elimination of poverty proved too overwhelming a task. Therefore, denial of any major role for the state in economic and social affairs has resulted in national parliaments and governments losing control of their countries' destinies. As UNRISD (*ibid.*:p.128) states: "Globalisation and market-based economic reforms have weakened many of the institutions that in the past have assumed responsibility for human welfare — while passing on to others burdens that they cannot be expected to bear".

In fact, as the experience of Korea[1] and Taiwan has shown, to achieve successful economic reforms, states need high levels of internal cohesion and corporate autonomy. That is, the concept of 'embedded autonomy' to capture the combination of both independence and support that is required for the consolidation of successful economic reforms (Evans, 1989:pp.139-181).

[1] Korea wherever mentioned in the thesis refers to the Republic of South Korea.

In terms of growth, it is apparent from the data available (Taylor and Pieper, 1996:pp.29-43) that SAPs have slowed growth rates in the case of countries in Sub Saharan Africa and Latin America — the countries which introduced market reforms rigorously. In Latin America, for example, the growth rates declined from an annual average of 4.9 per cent during 1970-82 to 1.9 per cent during 1983-90 and then to 1.0 per cent during 1990-93. Whereas in Sub-Saharan Africa they declined from 3.7 per cent to 1.3 per cent during the first two periods, but grew slightly higher to 1.8 per cent during the third period, yet this rate was almost half the growth rates achieved during 1970-82. In the Middle East, the average annual growth rates also declined from 3.7 per cent during 1970-82 to 0.9 per cent during 1990-93 (*ibid.*:pp.32-33).

In terms of social welfare, according to the *Human Development Report* (UNDP, 1992), the human impact of privatisation has been dismal. In every country for which data are available the proportion of population living in poverty has increased. In Bulgaria, the Czech Republic, Poland, Romania and the Slovak Republic, the number of households living below the poverty line has risen sharply.

In the case of Mexico, which is viewed by the IFIs as a showcase for debt management and restructuring, average annual growth rate during the period 1980-90 declined to 1 per cent compared to an average annual growth rate of 6.5 per cent during 1965-80, while average annual rate of inflation increased to 70.3 per cent from 13.0 per cent between these two periods (World Bank, 1992:pp.219-221). Meanwhile, its total external debt increased from US$ 57 billion in 1980 to around US$ 97 billion in 1990 (World Bank, 1992:p.259 and 1997b:p.219).

Among the most serious consequences of the reform programmes is the rapid fall in real wages. In Chile, for example real industrial wages in 1986 were 7.9 per cent lower than they had been in 1980. In Mexico, the fall was 33.9 per cent and in Peru, 34.5 per cent. The situation in parts of Africa was equally bad. In Kenya, for example, real non-agricultural wages in 1985 were 22 per cent lower than they had been in 1980, whereas in the United Republic of Tanzania in *1983* the fall was 40 per cent. Only in Colombia and Brazil real industrial wages were higher by 16.5 per cent and 12.8 per cent respectively in 1986 than they had been in 1980 (Griffin and Knight, 1992:p.584).

In Eastern Europe and the Commonwealth of Independent States (CIS), unemployment has ballooned (from zero) since the start of reforms in 1990, with wage employment falling sharply by as much as 30 per cent in Bulgaria and Hungary. In Kenya unemployment has risen to 29 per cent and in Algeria to 21 per cent (UNDP, 1996:pp.87-89).

Ironically, the neo-classical economists and World Bank experts accept — *albeit* with some qualifications — the need for government intervention to generate human capital, and since in most LDCs the state has not withdrawn from this area, it is precisely this aspect of development that has not suffered heavily from the neo-classical resurgence.

As the 1996 *Human Development Report* (UNDP, 1996) indicates, though Latin America and Sub-Saharan Africa faced severe economic problems, in Latin America there were considerable improvements in human development, in part as a result of deliberately accelerated efforts through policies.

In Latin America, between 1980 and 1990, life expectancy increased from 63 to 70 years, adult literacy improved from 80 to 86 per cent, and infant mortality declined by a third, from 69 per thousand live births to 45 (*ibid.*:p.17).

However, the picture is quite the reverse in countries which have seen the collapse of communism and the retreat of the state. The magnitude of the social and economic crisis in the transition economies of Central and Eastern Europe is underscored by a significant deterioration of health and education indicators. Taylor and Pieper (1996:pp.76-77) study indicates that real incomes have gone down by 39.2 per cent in Bulgaria and 38.3 per cent in Poland during 1989-93, while secondary school enrolment has gone down by 19.8 percentage points in Romania and by 12.0 percentage points in Albania during the same period. In Russia male life expectancy has gone down by 5.2 years during this period.

An examination of export performance of the developing countries over the period 1970-1990 reveals very clearly that despite the widespread economic reforms instituted by most of the developing countries, their share of world exports has either declined or stagnated — with the exception of the countries of South and South East Asia, which include the NICs, where these have increased.

For example, the share of developing countries in America[1] and in North Africa in world exports declined from 5.5 per cent and 2.3 per cent respectively in 1980 to 3.9 per cent and 0.9 per cent respectively in 1990; while the share of other African countries declined from 2.4 per cent to 1.1 per cent during the same period. In the case of heavily indebted countries[2], despite the fact that it is this group of LDCs which had to adopt the IFIs sponsored SAPs from the mid 1970s, their share of world exports declined from 6.5 per cent in 1980 to 4.6 per cent in 1990 (UNCTAD, 1991:pp.430-435).

Associated with the decline in their share of world exports, has been the deterioration in their terms of trade. For heavily indebted countries, the index of their terms of trade declined to 77 in 1990 (1980 = 100), for the developing countries in America the index declined to 76, and for the North African nations it declined to 69, while for other African countries it declined to 70 (UNCTAD, 1994:p.42)

Thus economic and social development of the last 15 years in a number of developing countries has been disappointing. In their quest for balancing the economy, these policies have unbalanced the lives of their people. The counter-revolution in

[1] This includes, Chile, Brazil, Venezuela, Mexico, Argentina and so on (UNCTAD, 1991:pp.430-438).
[2] These are: Argentina, Bolivia, Brazil, Chile, Colombia, Cote d'lvoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela and Yugoslavia (*ibid.*).

development theory would appear to suffer exactly the same pitfalls and loopholes that the old style development economics and development planning were accused of.

The problem of development is therefore, not simply one of reducing the role of the state and increasing that of the market. On the contrary, on balance the case for having a proactive state is strong. So rather than making states weak and passive, initiating economic reforms actually demands strong and active states — as well as effective mechanisms for agreement between the government, the business sector and other interests in society such as the trade unions and citizens organisation. Therefore both state and markets must act in tandem.

1.6 The Role of State and Market in Oman's Development

As stated in the introduction to this chapter, Oman provides an interesting example of public-private partnership. It is, therefore, important to examine how Oman was able to achieve successful socio-economic transformation at a time when the whole discipline of development economics and development planning was under attack. Since Chapters IV to VI will examine closely the process of development in Oman from the early 1970s, this section will provide a brief analysis of the central issues of social and economic development and the complementary roles of the state and market in Oman.

In order to put Oman's development in perspective two important points need to be considered. First, that planning for development in Oman began when development economics and development planning in particular, were under attack in the 1970s, both from leading economists, for failure to address the problems of poverty and inequality, and from the neo-classic counter revolution that was calling for, *inter alia*, the dismantling of planning and the 'rolling back' of the state. Oman was able to achieve the dual goals of growth and human development within this hostile environment, under the aegis of the state, as we shall see. An important feature of Oman's development strategy has been the 'political will' and commitment on the part of the government to develop the country.

This was done by adopting a state-led development strategy which aimed to tackle problems specific to Oman and which, in the absence of this planned response, would either not have been effectively dealt with or would have taken much longer to solve.

Second, although Oman's development strategy (Al Yousef, 1995:p.55) — which was approved by the Development Council in 1975 — emphasised the important role of the market in the development process, the initial conditions of acute underdevelopment then prevailing in the country deterred Oman from adopting the doctrine of *laissez-faire* advocated by the neo-classical school. It was thought that there was no alternative to a substantial intervention by the state in order to achieve a satisfactory rate of resource mobilisation for economic development.

As a result, Oman made significant progress in human development. Gross primary enrolment in education, as a percentage of relevant age group, increased from a very low level of 1 per cent for females in 1970 and 6 per cent for males, to 82 per cent for females and 87 per cent for males in 1993 (World Bank, 1997b:p.12). Total employment increased from 32,348 in 1970 to 617,648 in 1995. Life expectancy at birth increased from about 44 years in 1970 to 68 years in 1995 while infant mortality declined from 64 per 1,000 live births in 1980 to 20 in 1995 (Oman, 1996c:p.6).

Although growth is not identical with development it is nevertheless one of the important elements that constitute the latter. Moreover, as Seers (1969) has argued, growth was a necessary pre condition for sustained development — for how else could mass welfare continue to rise over time? Therefore, associated with human development has been the large increase in real per capita income. Oman is classified today by the World Bank as an Upper-middle-income country, having a GNP per capita of US$ 4,820 in 1995. Real GDP has also grown at an impressive annual average rate of 8.3 per cent during the period 1980-90 and 6.0 per cent during 1990-95, while inflation rate has been below zero (World Bank, 1997b:pp.8, 130 and 207).

1.7 Conclusion

This chapter has shown that the dominant viewpoint regarding the role of the state and the role of the market in governing developmental activities has swung from one extreme to another. The economic performance of the East Asian countries has fuelled the ideological discourse of free market economists and politicians who try to find in the legendary success of the Asia Pacific, the lost paradise of '*laissez-faire*' capitalism. On the other hand, the low performance of a number of developing countries has been cited as a proof that it does not pay the government to tamper with the market mechanism. Moreover, the post-1980 geopolitical upheavals have brought the state versus market debate to the centre stage in the developed world and in the IFIs. The aspiration of developing countries to work towards alternative ends by alternative means is regarded as illusory or misguided.

This chapter has discussed the evolution of state-led development from 1950 onwards. By drawing on the experience of Oman and a number of developing countries, we have argued that it is quite misleading to view the market and the state as conflicting entities. Instead they do and can co-exist in a state of co-operation and act in tandem to promote development.

Moreover, we have shown that most developing countries have been able, through a state-led development strategy, to achieve significant reduction in infant mortality, increase in life expectancy and extension of education to levels far beyond what might have been thought possible in 1945. Therefore, we would argue that it is totally inappropriate to distinguish government failures from market failures. As Toye (1993:p.89) argues:

> All markets are made within some legal, social and political framework of institutions ... [A]nd government failure is not just a matter of bureaucratic inertia or empire building, it is

> the outcome of creating organisations to regulate economic activity in the public interest which are then systematically frustrated by the political power of interests which they have been set up to regulate.

Among the lessons to be learnt from the ongoing state versus market debate in development is that one should reconsider the basic issue of the 'content' of development by treating it as a multi-dimensional phenomenon. Per capita income growth is only the means to achieve the end objective of human development.

Once the multiple goals of development are accepted, the role of the state in the promotion of human development in developing countries becomes clear. As we have shown critics of state-driven development strategies would find it hard to refute the fact that between 1950 and 1985 the developing economies in general and a country like Oman in particular made enormous progress in relation to the three crucial criteria of human development viz. school enrolment, life expectancy and infant mortality. The role of the state was very crucial in this progress.

CHAPTER II

THEORIES AND STRATEGIES OF DEVELOPMENT

2.1 Introduction

The policies and strategies formulated by the state to secure economic and social development are derived from a range of theories that attempt to analyse the causes of, and the means to overcome the lack of development. Therefore, a discussion of these theories and strategies[1] is necessary to understand the conceptual underpinnings of the major theories of development in the context of the state versus market debate. For example, the pro-market, minimal state and structural adjustment policies discussed in Chapter I are informed by the precepts of neo-classical economic theory. This chapter, firstly, provides an analysis of the major theories and strategies of development from the perspective of various schools of development thought. This is followed by a brief examination of the relevance of these theories and strategies to the development experience of Oman. The chapter concludes with an analysis of the role accorded to the state by these theories and strategies in the context of development.

2.2 Concept of Development

Development is both an end and a means. It is an end in the sense that it tends to prescribe certain normative order; it is a means in the sense that such normative order can only be realised through specific policies and strategies. In either sense, the question of development involves certain decisions by policy makers. The decision-making process involves the following assumptions that adoption of one or another development policy

[1] As we shall see in section 2.4 of this Chapter and as Hettne (1990:p.3) states, distinctions between 'theory' and 'strategy' are in a real situation not easily drawn.

involves a sequence of examining and preferring different alternatives and accepting an alternative which is considered to be the most satisfying to the decision-makers.

Be that as it may, there are contesting concepts of the meaning of development, as its meaning or the items that comprise it have changed over time. This section provides an overview of the meaning of development over time.

The subject of development economics has been among the oldest branches of economics and it was the main, if not the only, concern of economists from late 18th to 19th century. As Lewis (1984b:p.121) points out, what Adam Smith, in his *Inquiry into the Nature and Causes of the Wealth of Nations* called "the Natural Progress of Opulence" is what we would today call "development economics". However, from the late 19th century up to the Second World War, growth and development were forgotten as optimisation of allocative efficiency and maximisation of satisfaction and profits became the prime, if not the only, concern of economists. Thus, the return to growth and development did not take place until after the Second War. In fact, the term economic development was rarely used before the 1940s.

The late 1940s and 1950s then became in many respects the pioneering[1] period for development economics that focused on the problems and obstacles to development in the underdeveloped world. During this period, most economists came to interpret economic development as denoting growth in per capita real income in underdeveloped countries. Meier and Baldwin (1957) defined economic development "as a process whereby an economy's real national income[2] increased over a long period of time. And if the rate of

[1] The post World War II period, 1940s and 1950s is regarded as the pioneering period when several seminal works in development economics were published as the countries of Asia, Africa and Latin America attempted to emerge from their pervasive and persistent poverty. These pioneers included, Peter Bauer, Colin Clark, Albert O. Hirschman, Arthur Lewis, Gunnar Myrdal, Raul Prebisch, Paul N. Rosenstein Rodan, Walt W. Rostow, Hans W. Singer and Jan Tinbergen (Meier and Seers, 1984:p.ix).
[2] "Real national income" refers to the country's total output of final goods and services, expressed not in money terms but real terms; the money expression of national income must be corrected by an appropriate price index of both consumer and capital goods (Meier and Baldwin, *op. cit.*:p.3).

development is greater than the rate of population growth, then per capita real income would increase" (p.2).

Similarly, the group of experts appointed by the UN Secretary General suggested in its report on *Measures for the Economic Development of Under-developed Countries*, that the term, 'under-developed countries', be defined as those countries whose real per capita income (in US dollars) was lower than real per capita income of USA, Canada, Australia and Western Europe (Higgins, 1959:p.6).

As a result, the level and growth rate of real per capita[1] income came to be widely accepted as the standard yardstick for assessing the level and pace of economic development achieved by a country.

Following the recommendations made in the UN report, the World Bank has been for years using per capita income as an index of development for classifying countries into three main categories viz. Low-income, Middle-income and High-income. Almost all developed countries belong to the High-income group whereas most developing nations fall in the Low and Middle-income groups[2] with a few exceptions like Hong Kong, Kuwait, Singapore and UAE which fall in the High-income group. What is important to note is that no developed country is in the Low-income category.

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[1] The main advantages of using sustained increase in real per capita income as the definition of economic development are: its meaning is precise, it is easy to measure, and by comparing a country's economic growth with population growth it indicates whether an average citizen's income is increasing or not. Economic growth means increase in the real *aggregate* national income of a country. Thus economic growth is a necessary but not a sufficient condition for economic development.

[2] Oman, as we noted in Chapter 1, is classified as being an Upper-middle-income country (World Bank, 1996).

To facilitate cross-country and inter-regional comparisons, the World Bank converts a country's per capita GNP into US Dollars by applying what is called World Atlas method[1]. The World Bank also provides data on per capita GNP for member countries after adjusting them for Purchasing Power Parity (i.e. in ICP dollars)[2].

Although not stated explicitly, it was generally assumed that as economic growth would "trickle down" to the whole population, the objective of poverty reduction which was at the heart of the concern for development, would be taken care of. However, by the late 1960s, on the basis of empirical data obtained for a number of developing countries, it was apparent that despite achievement of high growth rates, reduced infant mortality, increased life expectancy and greater access to education, the problems of absolute poverty, basic human needs and chronic under-utilisation of human resources remained unaddressed.

As we noted in Chapter I, a number of development economists including Dudley Seers (1969), Denis Goulet (1971), Mahbub Ul Haq (1973), Paul Streeten (1981b) and Amartya Sen (1983) called for a shift in emphasis from economic growth to a broader concept of development. In their view, the strategies of development adopted had failed to attack the fundamental problems of absolute poverty despite the fact that they had

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[1] Under this method, for converting a country's income in local currency into US dollars the conversion factor used is the average of a country's exchange rate for that year and its exchange rate for the two preceding years, after adjusting for differences in rates of inflation for the concerned country and five developed countries. The formula for this method is given in Statistical Methods, Technical Notes given in any annual World Development Report.

[2] The purchasing power parity (PPP) of a country's currency is the number of units of that currency required to purchase the same (or similar) representative basket of commodities that a US dollar (reference currency) would buy in the USA. Real GDP per capita (PPP $) means real per capita GDP of a country in purchasing power parity of that currency. The system of purchasing power parity has been developed by United Nations, International Comparison Programme (ICP). Hence PPP $ is often called ICP dollar. The details of these are explained in the Technical Notes, of the annual World Development Report. For instance, since the purchasing power of a dollar (at prevailing exchange rate) in Oman is much higher than in USA, Oman's per capita income in 1995 was US$ 4,820 but at PPP it was US$ 8,140 (World Bank, 1997b:p.8).

succeeded in raising the real per capita income[1], rate of capital formation, import substitution, total factor productivity, share of industrial output etc.

In 1990 UNDP launched its first *Human Development Report* whose central message was that while the developing countries have made significant progress towards human development in the last three decades, development strategies for the 1990s should combine a number of objectives. Among these, "accelerating economic growth, reducing absolute poverty and preventing further deterioration in the physical environment" (UNDP, 1990:p.61) should be the principle ones.

The report also defined the basic objective of development as, "[t]o create an enabling environment for people to enjoy long, healthy, and creative lives" (*ibid.*:p.9). It also introduced the Human Development Index[2] (HDI) for measuring three essential elements of human development — longevity, knowledge and decent living standards. Despite its limitation, since the income per head conceals distributional aspects, the HDI is a better indicator of human development than per capita income. Moreover, it focuses attention of policy makers on important social sectors, policies, and achievements, which are not caught by the income measure.

2.3 Historical Perspectives

While the problems[3] the early development economists set out to investigate were distinct from the issues that constituted the subject matter of contemporary mainstream economics, it was inevitable that they should bring to bear on these problems the elements

[1] However, it is important to note that in the absence of other appropriate tools for measuring development, using growth in real per capita income was the second best alternative. Moreover, since most of the newly independent countries were in an acute stage of backwardness and underdevelopment, they had to subordinate the distributional aspects of development to the urgent task of 'kick-starting' the development process, although the pitfalls of using per capita income as a measure of development were clearly raised by economists like Viner (1953).
[2] The latest Human Development Index measures income per head (by using purchasing power parities established by the World Bank) life expectancy, adult literacy and combined first, second and third level gross enrolment ratios (UNDP, 1997:p.146).
[3] These were problems relating to poverty in underdeveloped countries and the potential way forward to achieve economic progress in these countries.

of dominant paradigms of the past. There were, of course, certain problems related to underdevelopment which most economists were ill-suited to conceptualise. These problems can be subsumed under the term 'political economy'. By this was meant the whole complexity of political and social processes and institutions which acted as 'inertia' in the process of transformation of the developing countries.

Initially, the main preoccupation of these economists was largely to identify those variables that could provide the key to future economic growth, and the analysis of possible long-term growth paths and strategies. Therefore to determine the sources of growth and delineate strategies of development to overcome the many obstacles to development[1], the development economists had to conceptualise, deduce principles, build models, and establish conceptual and empirical relationships in this undertaking. Thus the historical perspectives on development — which we shall review briefly — were revitalised, and new attempts were made to produce a development theory most suited to the needs of underdeveloped countries. The purpose, however, is not to provide a detailed analysis, but to identify main elements of these theories.

2.3.1 The classical economists

The main approach of classical economists was to discover the causes of long-run growth in national income and the process by which this growth occurs. Problems such as the way a nation allocates a given supply of productive resources among alternative uses or how individual consumers or business firms reach economic decisions were of little interest to classical economists (Meier and Baldwin, 1957:pp.19-45).

[1] Obstacles to development are associated with characteristics of poor countries. These are: (i) they are primary producing, (ii) they faces population pressures, (iii) they have underdeveloped natural resources, (iv) they have an economically backward population, (v) they are capital-deficient, and (vi) they are foreign dependent. Other obstacles to development, which are implicit in the above characteristics are: (a) market imperfections, (b) vicious circles that are both a cause and consequence of poverty, and (c) international forces relating to the role of poor countries in the world economy (Meier and Baldwin, 1957:pp.273-333).

Among the classical economists, the leading contributors were: Adam Smith — *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), Malthus — *An Essay on the Principle of Population* (1798), Ricardo — *The Principles of Political Economy and Taxation* (1817), Mill — *Principles of Political Economy* (1848), and Young — "Increasing Returns and Economic Progress" (1928).

One of the essential features of the classical growth theories is an analysis of the process by which a portion of the economic surplus available in the community is employed for the purpose of capital accumulation.

Thus Smith strongly emphasised that saving was a necessary condition for economic development. Therefore, his emphasis on the importance of capital accumulation in the development process became a fundamental element in later development theories as we shall discuss later.

While Smith is identified with the policy of *laissez-faire*, he nevertheless saw a role for government: first, providing for national defence; second, administering justice through the court system; third, maintaining public institutions and resources such as roads, canals, bridges, educational systems, and the dignity of the sovereign (Smith, 1776).

For Ricardo and others of the classical school, free trade[1] enables the benefits of specialisation and the division of labour to be reaped on an international basis. World income is raised by more efficient utilisation of resources. However, a notable exception to the free trade case is made in the "infant industry argument". "A protecting duty, continued for a reasonable time, might sometimes be the least convenient mode in which the nation can tax itself for the support of such an experiment" (Mill, 1848:p.922, as cited in Meier and Baldwin, 1957:pp.40-41).

[1] However, it is important to note that this was based on the assumption of international factor immobility (Meier and Baldwin, *op. cit.*).

However, the classical economists were discussing the growth of 18th century European capitalism, not propounding a universal theory of global economic development and under-development; moreover, analyses of most classical theorists are based on an economic environment in which development occurs and — most important — where institutions and attitudes favourable to development already exist. Since these conditions did not prevail in most of the LDCs in the 1950s, their analysis and policy recommendations required modification; as we shall examine later. Another aspect relating especially to Ricardo is his theory of comparative advantage. This has been misread and misinterpreted in its application to the present day developing countries and their place in the global economy. Ricardo's theory of comparative advantage relates to the structure of production and trade between similarly placed developed countries. He was referring to England and Portugal which were at that time, similarly developed. In a real sense, Ricardo's theory is not relevant to the relationship existing between the present day developed and developing countries because these are not similarly placed.

2.3.2 The Marxian perspective

There are many aspects of Marx's theory which are of relevance for development, including the colonial system, class interests, the development of one mode of production to another[1]. For Marx, the capitalist mode of production and the rise of the bourgeoisie are symptomatic of the development of productive forces and hence development. However, our concern with Marx's theory of development is limited to our analytical concerns rather than to providing a comprehensive discussion of this theory.

[1] According to Marx's economic (materialistic) interpretation of history, the development process consists of various stages of which capitalism is one of the stages which is preceded by feudalism and followed by socialism. Each of these stages of development is characterised by a particular 'mode of production' the physical aspect of which relates to the accumulated capital and technology and the social aspect of which the social relations arising from production process i.e. the class structure of society. In each mode of production (i.e. at each stage of development) the class structure consists of two main classes; the 'dominant' class appropriates and uses 'surplus' produced by the 'oppressed' class. For instance, in feudalism the two opposite classes are landlords and serfs (and bonded peasantry) and under capitalism the class struggle is between the capitalists and the proletariat.

Marx explained why capitalist system is characterised by cumulative growth[1] and why this process is beset with contradictions[2] which bring about the downfall of capitalism.

There are, however, two main strands in Marx's theory of development which are of relevance for us. Firstly, there is the rather abstract analysis of the capitalist mode of production which has brought about the transformation and development of the Western economies. Central to this analysis is Marx's expanded reproduction scheme based on circuit (and accumulation) of capital between Department I dealing with the production of capital goods and Department II dealing with the production of consumption goods (Nazir, 1991:23-28). Secondly, there is Marx's more concrete analysis of the development of capitalism in the colonised countries. Relatively speaking, Marx's theory is rather less systematic in analysing this situation (Maurice Dobb, 1960), though developing socialist societies like China have made enormous progress utilising Marx's theories and models of development. For Marx, a developed economy is characterised by the presence of large indigenous capital goods and technology generating sectors; conversely an absence or weak development of this characterises an undeveloped economy. The process of development occurs when surplus is invested in Department I sectors which then determines the other sectors of the economy i.e. Department II and Department III, producing means of consumption and of luxury goods respectively. All developing countries which have either achieved or nearly-achieved developed country status such as South Korea, Taiwan, China and India have substantial Department I

[1] According to Marx, the difference between feudal lords and capitalists is that the latter reinvest most of the surplus they "exploit" from the proletariat. This raises labour productivity and, with wages remaining at subsistence level, increased productivity further enlarges capitalists' surplus. Thus accumulation leads to more accumulation and growth becomes cumulative.

[2] With capital accumulation growth of output increases, but since wages are kept at subsistence level (through the reserve army of unemployed) income distribution moves in favour of capitalists and against the working class. This leads to the underconsumption crisis and depression because compared to workers the capitalists have relatively lower propensity to consume. Marx argued that these and other contradictions inherent to capitalist development would result in intensification of class conflict which, as workers get organised, would lead to socialist revolution and collapse of capitalism.

production; i.e. capital goods, machine-building and technology generating sectors (Nazir, *op. cit.*).

2.3.3 Neo-classical theory

Although we have examined closely the neo-classical paradigm and its approach to policy making in developing countries in Chapter I, we need to summarise here its main propositions, since this paradigm constitutes part of the historical legacy which influences contemporary development thought and practice.

The neo-classical economists focus their attention on issues of allocative efficiency — how resources come to be allocated to different uses, and the criteria which need to be fulfilled if the value of the output generated from a given stock of resources is to be maximised. The core of the neo-classical paradigm was systematically articulated in Marshall's *Principles of Economics* (1890), as cited in Hunt (1989:pp.31-33). The paradigm consisted of eight main elements.

First, it is desirable to maximise aggregate economic welfare. Second, the prices for goods and services which are generated by the unimpeded operations of the market are normally the correct prices for the purposes of guiding resource allocation. Third, factor prices should be determined through the operation of the free market. Fourth, given infinite technical choices and fully flexible factor prices, the maximum value of output and hence, maximum social welfare, will always be achieved by full employment of all factors of production. In equilibrium, *there will be no involuntary, general unemployment* (emphasis added by the present author), though partial unemployment would occur. General unemployment, when it occurs, is a temporary disequilibrium. Fifth, in the absence of government intervention, factor prices combined with the distribution of asset ownership determine interpersonal income distribution. Factor prices correspond to marginal productivities which in turn are determined by relative scarcities. Sixth, the main corollary of neo-classical theory is that, in any market, price distortion will lead to a distorted pattern of resource allocation with a consequent reduction in efficiency and welfare, i.e. "get the prices right". Seventh, like classical economists, neo-classical writers stress the advantages of unrestricted international trade which will allow a country to raise its national income. And finally, growth is a gradual, harmonious process resulting from 'marginal' adjustments by innumerable, independent economic agents.

2.3.4 Schumpeterian analysis

In his *The Theory of Economic Development*, Schumpeter (1911) contends that there is no immutable law of diminishing returns or Malthusian population pressure to crush progress as in Ricardo's theorem; neither is there an inherent tendency towards a maldistribution of income which produces increasingly severe crises as in Marx. On the contrary, Schumpeter contends that capitalism can yield ever higher levels of real income at the cost of nothing more than temporary interruptions in economic activity. While he disagrees with the neo-classical description of development as a gradual, harmonious process, he agrees with Marx that development is a dynamic, discontinuous process.

Schumpeter argues that successful capitalism implies not just the existence of capitalists, meaning those who own capital, but more importantly entrepreneurs, meaning those who innovate, who put various factors of production together and who take risks and face uncertainties regarding the success of their innovations. To Schumpeter, 'development' means a change in output by a shift in production function resulting from an innovation. Entrepreneurs are innovators by definition, so in a developing capitalist society there must be a sufficient supply of successful entrepreneurs. In contrast, growth means incremental (marginal) changes in output along the same production function resulting from marginal changes in supply of factors.

Thus the central figure in development process is the entrepreneur. Innovation may occur in the following forms: (a) the introduction of a new product; (b) the use of a new method of production; (c) the opening of a new market; (d) the conquest of a new source of raw material supply; or (e) the reorganisation of any industry (Schumpeter, 1911:p.66).

By emphasising the distinction between growth and development, between entrepreneurs and capitalists, and between credit creation and mobilisation of savings for financing capital formation, Schumpeter distanced himself from the classical economists as well as from Marx .

As we shall see, Schumpeter's emphasis on the importance of entrepreneurship in economic development had an important bearing on the role of the state in the development process.

2.3.5 The Keynesian contribution

The great international economic depression of 1930s witnessed what is widely known as the 'Keynesian Revolution' in economic theory. During that period, Keynes identified the role of effective demand in determining aggregate output and employment. Keynes' General Theory (1936) was indeed innovative because it suggested that attempts to cut wages during a recession may exacerbate the downward spiral of output and employment, and that increased public sector spending during recession might be a virtue and not a vice (*ibid.*:p.26).

In his General Theory of Employment, Interest and Money, Keynes assumed the following elements as given and constant: "[T]he existing skill and quantity of available labour, the existing quality and quantity of available equipment, the existing technique, the degree of competition, the tastes and habits of the consumer" (*ibid.*:p.245). In other words, the factors on which long run economic growth depends were assumed as given by Keynes. Hence, in contrast to classical economists, Marx and Schumpeter, who were mainly concerned with problems of long-run growth, Keynes' approach was confined to problems of income determination in the short-run, particularly in tackling depression and large-scale unemployment. As is well known, in defence of his short-run approach, Keynes made the famous statement that "in the long run we are all dead".

In their endeavour to give a dynamic form to Keynesian economics, Harrod (1939 and 1948) and Domar (1947), provided rigorous theoretical models of growth in which they analysed the conditions required for steady uninterrupted growth in real income with full employment and price-stability.

It should be noted in passing that the Harrod-Domar model has influenced many growth models in the developing countries, including the Mahalanobis model which has influenced Indian plan models. The Harrod-Domar model involves the familiar growth equation:

$$G = S/V$$

Here, the rate of growth of output, G, is expressed as a function of the savings ratio, S and the capital-output ratio, V. When the parameters are estimated econometrically, the equation becomes a planning equation in which the target growth rate, G (of GNP) is determined by the instruments S and V. It also gives the desired savings rate to achieve the target value of G. The model emphasises a consistent pattern of resource allocation between consumption and investment to ensure intertemporal resource allocation, in order to reach a targeted GNP growth rate, and a particular level of GNP by a certain date.

This model provided the elementary framework for considering the relationship between the growth rate of output, the growth rate of population and the growth rate of savings. Some aspects of this theory are discussed further below.

2.4 Contemporary or Modern Theories and Strategies[1] of Development

Development economics arose both as a theoretical discipline within departments of economics and development studies[2] as a practical subject in response to the needs of policy makers to advise governments of African, Asian, and Latin American countries on strategies to enable them to achieve development. The question raised was how development was to be achieved? For, while political independence could be legislated, economic independence could not. Economists were, therefore, called upon to provide advice on development.

In addition, there was the question of global political economy. The major capitalist countries perceived that if there was little social progress in the newly independent countries, they might fall under communist domination. If that happened then investment opportunities, and access to markets and sources of raw materials for the capitalist countries would be jeopardised. A political basis thus emerged in the early 1950s for a large-scale financial and technical aid from the richer countries. The IMF, the World Bank, and the General Agreement on Tariffs and Trade (GATT) established the basic institutions of what may be called an international public sector, thus providing additional international institutional support for national development efforts. Regional commissions of the United Nations also assumed an active role in examining development

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[1] Since development involves structural transformation, development theory is by definition interdisciplinary. Further more, development theory has from the start been closely related to *development strategy*, i.e. changes of economic structures and social institutions undertaken in order to find consistent and enduring solutions to problems facing decision makers in a society. Thus development theory implies a set of integrated concepts which attempt to explain causes, whereas strategy is more concerned with policy suggestions, and hence implies an actor, usually the state.

The closeness between theory and strategy, as Hettne (1990:p.3) articulates is due to the fact that problems were defined as *national* problems and that consequently development theorists particularly pioneers — addressed themselves to governments. Consequently, distinctions between 'theory' and 'strategy' are in real situations not easily drawn.

[2] Development studies is a wider concept involving inter-disciplinary approach to problems and strategies of development. It therefore involves socio-political, cultural and economic aspects of the state of underdevelopment and requires planners to take a holistic and practical view while suggesting development strategies/policies.

problems. Most notable, as we shall see later, was the Economic Commission for Latin America (ECLA) established in 1948.

A spirit of policy-optimism thus characterised the early views of the development theorists, in general, and development economists, in particular. As Paul Streeten observes: "It is not easy to convey in the present atmosphere of gloom, boredom and indifference, surrounding discussions of development problems, what an exciting time of fervour these early years were" (Streeten, 1981a:pp.61-62).

As stated in the introduction, a renewed interest in the development of the newly independent countries after the Second World War gave rise to development theory with its focus on the third world. The narrow theoretical framework prevailing at that time could not adequately analyse the problems of these newly independent countries which were specifically and qualitatively different from those of the industrial countries; thus economists increasingly had to incorporate more complex processes and variables in their theoretical perspectives, defining and redefining them as their understanding of the development process deepened and new problems emerged which had to be solved.

It is not necessary to review all the approaches that attempt to explain economic and social change in the developing countries. We shall identify the major schools of development theory and the contributions of some individual economists within these schools.

Whilst the various schools of development theory differ in what they consider to be issues of significance for achieving development, there are nevertheless certain issues which are common to all approaches. These are:

- the necessity of resource mobilisation for raising the rate of accumulation of physical capital;

- the need to industrialise instead of continuing with concentration on expansion of primary exports in exchange for manufactured imports;
- the need to overcome problems of market failures and imperfections through state-led development;
- the need to transform a subsistence, non-accumulative, primary production based economy into a surplus generating, industrialised economy;
- the importance of establishing an economically independent, self-sustaining economy liberated from the compulsions of serving the needs of developed capitalist economies;
- the need to address the problems of mass poverty and widespread deprivation of basic needs as the fundamental problems of underdevelopment;
- the necessity to ensure efficient allocation of resources as the primary requirement for self-perpetuating economic and social development.

On the basis of the conceptualisation and analysis of one or more of these issues, one can categorise development theory literature into the following three major schools of thought:

1. Capital Scarcity school[1];
2. Centre-Periphery (Structuralist) school (which includes the Dependency school[2]); and
3. Neo-classical school

These schools can also be distinguished on the basis of a group of the above items which constitute the 'causal factors' of development and underdevelopment.

It is difficult to fit these schools into a definite sequence of time periods, since their emergence and prominence in the evolution of development thought did not follow any chronological pattern. However, one can observe that in the 1950s and 1960s the first school stressing capital scarcity as the primary cause of underdevelopment did exercise

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[1] This school is sometimes classified as 'modernisation' school, see for example Dube (1988), So (1990) and Hettne (1990).

[2] See footnote to the sub-heading of section 2.4.2.2.

important influence over both the academic and policy-making economists. The contributions of Nurkse, Rostow, Leibenstein, Hirschman, etc. broadly fall within this school. These gained such prominence in the development literature that one can describe this school as the founder of mainstream development economics, and as the precursor of development studies as well.

Contributors in the second school of thought are often classified as "structuralists". These too, gained prominence during the first two decades of post-war period particularly in the developing countries of Latin America and in international organisations (with the setting up of the UNCTAD), mainly because they provided non-Marxist alternative theories of underdevelopment. The Centre-Periphery school stressed the relationship between trade and development by attributing the continued underdevelopment of LDCs to the composition and terms of trade between the developing countries (periphery) and developed countries (centre). They blamed structural rigidities in LDCs for the anti-developmental nature of this trade relationship. Broadly speaking, the neo-Marxian school advocating dependency theory also falls within the Centre-Periphery school because it attributes underdevelopment to the whole range of economic relationships between the LDCs and the developed capitalist economies which make the former dependent upon the latter.

These two schools occupied most of the space in development economics literature during the first three decades — mid-1940s[1] to mid-1970s — of its evolution. Although, there was considerable divergence of perspectives between these two schools, there were important elements of common ground also. Firstly, there was a widespread rejection of the neo-classical perspective based on equilibrium economics as a meaningful insight into the problems of underdevelopment and development. On the contrary, proponents of these schools considered economic development as a cumulative disequilibrium process, as Schumpeter had done. Secondly, except for Bauer and Yamey (1957), almost all theories belonging to these two schools rejected the static theory of

[1] Taking Rosenstein-Rodan's article of 1943 as the beginning of development economics.

comparative advantage as a basis for economic development. Lastly, most took the view that achievement of satisfactory resource mobilisation required a substantial degree of state intervention, but working in conjunction with market forces.

In fact, the overall tone was an optimistic one, in contrast to the pessimistic forecasts of the economists belonging to the classical, Schumpeterian and Keynesian traditions, who were worried about diminishing returns in agriculture, population growth, the undermining of the entrepreneurial spirit and falling marginal efficiency of capital leading to secular stagnation (Singer, 1978:p.2).

2.4.1 Capital Scarcity school

As we have noted earlier, sustained growth of real per capita income was treated as a significant measure of economic development in the post-war period. Since real per capita income is a function of capital per head, development was seen as a process of increasing capital formation as determined by the rates of saving and investment. The 1951 UN report, *Measures for the Economic Development of Underdeveloped Countries*, emphasised accumulation of capital as one of the obstacles which had to be overcome to promote development:

> It is a commonplace that economic progress is a function, among other things, of the rate of capital formation. In most countries where rapid economic progress is occurring, net capital formation at home is at least 10 per cent of the national income, and in some it is substantially more. By contrast in most underdeveloped countries, net capital formation is not as high as 5 per cent of national income, even when foreign investment is included. How to increase the rate of capital formation is therefore a question of great urgency (UN, 1951:p.35).

In fact, the acute underdevelopment prevailing in most newly independent countries is reflected by the low rate of capital formation in the 1950s which in countries like India and Pakistan did not exceed 6 per cent (Rostow, 1956:pp.154-189); while net domestic savings in most of the third world countries was below 8 per cent in that period (Meier and Baldwin, 1957:p.305).

Development was, therefore, primarily seen in post-Keynesian as well as Marxian economics as a process of capital formation determined by the rate of investment. The importance of saving and investing as stated by Lewis provides a general perspective in which the bulk of the development literature of the 1950s was produced.

> The central problem in the theory of economic development is to understand the process by which a community which was previously saving and investing 4 or 5 per cent of its national income or less, converts itself to an economy where voluntary saving is running at about 12 or 15 per cent of national income or more (Lewis, 1954:p.155).

Thus most of the pioneers in development approved of economic planning and were mainly concerned with the mobilisation of domestic resources. The main message was that development necessitated plans and strong, active governments to implement them. "Development was an art of large-scale social engineering" (Hettne, 1990:p.48). While it is not possible to review here all the theories and strategies that are relevant to this school, we will examine some of the main contributions.

2.4.1.1 Vicious circle of poverty and low level equilibrium trap

The basic problem in the underdeveloped countries, according to the capital-scarcity school, is to break out of the vicious circle that perpetuates itself due to insufficiency of capital.

Thus according to Nurkse, the low level of real per capita income in the under-developed countries is a reflection of low productivity, which in turn is due largely to lack of capital. The lack of capital is a result of the small capacity to save, which in turn, is due to low income and so the circle is complete[1]. "A country is poor because it is poor" (Nurkse, 1953:p.4). On the demand side, too, there exists a vicious circle since the inducement to invest is limited by the size of market and productivity is a crucial determinant of the size of market since "capacity to buy means capacity to produce" (Higgins, 1959:p.397). As Nurkse says "productivity depends largely, though by no means entirely, on the degree to which capital is used in production ... [B]ut for any individual entrepreneur the use of capital is inhibited to start with, by the small size of market" (Nurkse, 1953:Chapter 1, p.11). For Nurkse, the way out of the vicious circles was the transformation of the domestic economy via a Big Push to industrialisation.

The low level equilibrium trap hypothesis of Nelson (1956) and the critical minimum effort hypothesis of Leibenstein (1957)[2] also depend upon the relationships between capital formation and per capita income. Real per capita income and increase in capital stock (i.e. positive net investment) are mutually correlated, real income grows as net investment increases and saving and capital accumulation increase as per capita income grows.

[1] Low income leads to low savings and investments hence low growth. Low income meant a lack of aggregate demand, limiting the investment opportunities.

[2] For a very good summary of the Nelson model and Leibenstein model, see Higgins, B. (1959:Chapter 16, pp.388-397).

Since a moderate level of growth was eaten up by population[1] increase, a 'critical minimum effort' was required to break out of a population trap into cumulative growth. Liebenstein acknowledged that the effort would have to be substantial to make it possible to reap the benefits of external economies and to achieve 'balanced growth'. Since attainment of critical minimum effort would depend heavily on the development of entrepreneurship, knowledge and skills, governments could help to foster the growth of these factors (Leibenstein, 1957:pp.15-17, 96-106 and 111).

2.4.1.2 The strategy of balanced growth

The strategy of balanced growth propounded by Rosenstein-Rodan (1943 and 1961) and Nurkse (1953) is based on the argument that the main factor inhibiting the growth of investment in poor countries is lack of inducement to invest in plants of minimum economic scale because of the limited size of the domestic market. The problems of limited demand for individual industries can be resolved by the "balanced growth" of several inter-dependent industries which according to Nurkse is a more or less synchronised application of capital to a wide range of different industries (Nurkse, 1953:p.11). Nurkse argues that this strategy would lead to an overall enlargement of the market and hence an escape from the deadlock. This basic complementarity of markets arises on account of the diversity of human wants. As Nurkse puts it succinctly "The case for 'balanced growth' rests on the need for balanced diet" (*ibid.*).

Both Rosenstein-Rodan and Nurkse observed that in an underdeveloped economy, characterised by a 'vicious circle of poverty' the investment programme must be both massive and balanced. Thus Rosenstein-Rodan suggested that if exports are to be increased, production must follow a balanced growth path. This would be facilitated by

[1] Both these models bring an additional causal relation viz. the relationship between per capita income growth and population growth (using implicitly the theory of demographic transition). The relationship between population growth and income growth depends upon the stage of development. In the initial stage, population grows faster with income growth, then it tapers off and in the third stage population growth declines as income continues to grow.

issuing indicative plans and by small countries joining into customs unions within which large scale industries might be operated more efficiently (Rosenstein-Rodan, 1943).

Rosenstein-Rodan was therefore one of the first one to come in favour of the 'big push' development strategy, involving government intervention to co-ordinate and provide incentives for large scale investment. He argued that the crucial task of a development programme was to achieve sufficient investment to mobilise unemployed and underemployed for the purpose of industrialisation. And the area of industrialisation should be sufficiently large if the industrial enterprises are to reach an optimum size. In the same vein, he emphasised the importance of public investment in social overhead capital (SOC) and the need for state action to overcome market imperfections especially in underdeveloped countries. "[T]he price mechanism in such imperfect markets cannot therefore be relied upon to provide the signals that guide a perfectly competitive economy towards an optimum position" (Rosenstein-Rodan, 1984:pp.207-216).

Whilst Rosenstein-Rodan stipulated the need for state intervention to correct market failures, he rejected a strategy of self-sufficiency or an inward-looking strategy of industrialisation. As we shall see in subsequent chapters, Oman has also never adopted an inward-looking strategy.

Similarly, Nurkse's conclusion (as discussed earlier) is that the onus for breaking out of the vicious circle of poverty in backward countries rests firmly on their governments, with respect not only to planning a programme of balanced industrial investment but also to mobilising domestic resources and ensuring effective use of foreign and domestic resources through curtailing the growth of domestic consumption. Similarly, Nurkse argued that developing countries could no longer rely on economic growth being induced from outside through an expansion of world demand for their exports of primary commodities, and that less developed countries must pursue balanced growth conforming to the income elasticities of internal demand.

Although, the theory of the 'big push'[1] and balanced growth of investment in several complementary industries sounds appealing in theory, in practice it is difficult to put into effect in a developing country, simply because if a poor economy had sufficiently vast capital and entrepreneurial resources to invest simultaneously in several industries at minimum economic scale then it would not have been poor in the first place. Moreover, it is very difficult to maintain a balance between supply and demand over a wide range of sectors of the economy if there is no complete control over all the means of production. Also if a developing country were to have access to resources through external borrowing then the repayment of loans and consequent indebtedness would play havoc with the national economy, mainly due to falling terms of trade; the problem would express itself in balance of payment difficulties, dwindling foreign reserves, devaluation of the currency, and so forth. This is exactly the scenario that most developing countries had to face: borrowing more to pay interest on the loans.

2.4.1.3 Hirschman's strategy of unbalanced growth

Keeping in view the criticisms of the strategy of balanced growth, Hirschman (1958) suggested the unbalanced growth strategy to achieve a 'big push' in investment rate. He favoured raising the rate of investment through concentration in one or a few industries, i.e. through deliberately created imbalances. According to Hirschman, in advanced countries economic development has followed the path of unbalanced growth with growth being communicated from the leading sectors of the economy to the followers. Hirschman's strategy stresses the creation of external economies through interdependence of supply as opposed to balanced growth's emphasis on external economies created by interdependence of demand.

[1] Rosenstein-Rodan laid great emphasis on indivisibilities and increasing returns. The saving counterpart to his investment "big push" might come from decreasing costs. Thus he saw SOC as the most important instance of indivisibilities and externalities. "The provision of such "overhead costs" for the economy as a whole requires a large minimum size of investment in each infrastructure project ... A high initial investment in SOC is necessary to pave the way for additional, more quickly yielding, directly productive investments" (Rosenstein-Rodan, 1984:p.214).

Hirschman argued that economic development is more likely to result from the more feasible strategy of unbalanced growth. Establishing modern enterprises creates bottlenecks and shortages, offering high returns to people who can clear the bottlenecks, i.e. creating incentives for entrepreneurs to emerge. The policy prescription is to foster projects involving the most opportunities for profitable investment elsewhere in the economy, or in Hirschman's terminology to establish projects with the most linkages — backward and forward — (e.g. via the demand for inputs or activities using their output or via their impact on aggregate demand).

Hirschman proposed that policy makers and planners should not attempt to anticipate supply and demand imbalances, but rely on the market in revealing major resource bottlenecks. He also identified an interventionist role for the government in resource allocation. "Whereas assistance categories such as disease control and irrigation may give the state a new taste for developmental activities, price stabilisation supplies both the taste and, at some future time, the institutional mechanism to indulge it" (Hirschman, 1981:p.83).

While the development "theorists" have been debating the merits and demerits of balanced and unbalanced growth prescriptions, a majority of developing countries have, either by choice or by compulsion of circumstances, adopted the unbalanced growth strategy at least in the initial stages[1]. In Oman, for example, and as we shall see in Chapter V, it was not possible to adopt a balanced growth strategy. Thus the First and Second FYPs concentrated on developing a limited number of sectors (economic and social infrastructures) and regions (Capital area and the Southern region). Only in the Fourth FYP were resources allocated in a more balanced manner between regions and sectors of the economy and society.

[1] The classic and the oldest example of this is the socialist planning in Soviet Union which concentrated on capital-intensive, basic or core industries (producing basic inputs and capital goods) and gave low priority to investment in agriculture and agro-based consumer industries. India, too, followed the same pattern in investment allocation and gave high priority to develop heavy and capital goods industries (see Chakravarty, 1987:Chapters 1-3).

2.4.1.4 Rostow's theory of economic growth[1]

Presenting his analysis as an alternative to Marx's theory of modern history, Rostow (1960), in his "The Stages of Economic Growth : A Non-Communist Manifesto", posited his five stages of growth against Marx's modes of production comprising feudalism, bourgeois capitalism, socialism and communism. Rostow attempted a synthesis of the 'big push' and 'vicious circle' theories in his stages theory of economic growth.

Rostow's concept of take-off[2] into self-sustained growth is a crucial part of his stages of growth theory. According to this, economic development in any country occurs in five distinct but connected stages viz.: (i) traditional society; (ii) pre-conditions of take-off; (iii) take-off into self-sustained growth; (iv) the drive to maturity; and (v) the age of mass consumption. The essential factor that determines the stage at which a country is placed is the rate of investment or capital formation[3] which is largely determined by the rate of saving. For instance, in the first two stages, the investment rate is 5 per cent or less, in the third stage it is between 10 per cent to 15 per cent and in the last two stages it is above 15 per cent (Rostow, 1960:pp.4-16).

Thus once any less developed country arrives at the take-off stage, it will experience cumulative, self-sustaining growth which would transform it into a developed country. (In terms of Nurksian analysis a country is caught in the vicious circle of poverty before the take-off stage but after it progresses to the take-off stage, it will enter into the virtuous circle of prosperity). For the LDCs, the most critical issue is to reach the take-off stage. To accomplish this task it needs to meet the following three conditions: firstly, to raise the rate of productive investment to over 10 per cent; secondly, to develop one or more manufacturing sectors with high growth potential; and thirdly, to create a

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[1] Since Rostow's theory emphasised the importance of saving and investment as a crucial element in the development process, it is classified under the Capital Scarcity school.
[2] Corresponding to Rostow's take-off stage is Gerschenkron's "great spurt" (Gerschenkron, 1962).
[3] As a per cent of national income.

framework of social, political and economic institutions that would facilitate the tendencies to expand the economy and obtain external economies of the modern sector.

For Rostow, the rate of investment of 10 per cent or above is a necessary but not a sufficient condition. According to Rostow:

> [I]t is nevertheless useful to regard as a necessary but not sufficient condition for the take-off the fact that the proportion of net investment to national income (or net national product) rises from, say, 5 per cent to over 10 per cent, definitely outstripping the likely population pressure, and yielding a distinct rise in real output *per capita* (Rostow, 1960:p.37).

Rostow's crucial stage — the take-off — features two main elements or processes; one is the sharp increase (doubling) of the rate of capital accumulation and the other is the concept of the leading sector. With its implied transformation of the production structure, implicit in Rostow's theory is the necessity for governments to assume responsibility for directing their country's development. Through government action a more favourable environment for take-off might be created.

2.4.1.5 Theory of dualistic development

While definitions of dualism abound[1], we will examine briefly the major contributions that deal with the obstacles arising from the 'dualistic' nature of

[1] Eckaus (1955) and Higgins (1956) focus on the differences in technology between two sectors, one traditional with variable technical coefficients, the other, modern with fixed coefficients. Others like Singer (1950a and 1970) extend this notion to the international arena to trace the impact of international dualism on domestic Third World development in the Myrdal (1968), Prebisch (1971) tradition (as cited in Ranis, (1988:p.74).

underdeveloped economies: the coexistence of an advanced modern sector with a backward traditional sector.

The main advocates of the Dualistic Development theory are Boeke (1953), Lewis (1954), Higgins (1956), Myrdal (1957) and Myint (1958 and 1985). The main features of dualistic development prevailing in most developing countries include: (a) the economy is divided into two sub-economies one which is superior or modern in terms of technology, capital stock and economic organisation and the other which is inferior or traditional; (b) the "development gap" between the two sub-economies tends to widen on account of what Myrdal calls forces of "cumulative causation" and "backwash effects" (Myrdal, 1957); (c) the traditional sector does not benefit from the percolation or trickling down of the fruits of the rapid growth experienced by the modern sector, and this is reflected in an unequal provision of public services and social infrastructure that favours the modern sector over the traditional sector; and (d) theoretically the modern (superior) sub-economy is found in the urban, industrial sectors and the traditional one in the rural, agricultural sector.

These theorists argued that the structural characteristics of the modern capitalistic sector and the traditional subsistence sectors are such that despite vast differences in rewards obtainable in the two sectors, labour, entrepreneurship and capital do not move between the two sectors in such a way that in the long run equilibrium[1], the levels of development in the two sectors would be equal, even though they may specialise in differing branches of production. Therefore in designing appropriate strategies, development economists had to address the ultimate question of how to expand the modern exchange sector while the traditional sector contracts.

[1] According to the neo-classical equilibrium economics, surplus capital of modern sector should move to capital-scarce traditional sector and surplus labour from traditional sector should move to high wage modern sector. These equilibrating processes should in the long run equalise factor productivity, incomes, and social development levels in the two sectors. But, as Myrdal (1957), Boeke (1953), Higgins (1956) and Myint (1958) have argued, the dualistic character of a developing economy refutes the basic tenets of neo-classical equilibrium economics (Meier and Baldwin, 1957:pp.324-333).

Similarly, in the structuralist view of development, rigidities of various kinds preclude the rapid and quantitatively significant response of the economy to changing incentives as conveyed by market signals. Therefore, as we shall see in subsection 2.4.2.1, development will be hampered unless strategies (e.g. import substituting industrialisation) that alleviate structural rigidities are adopted. Dualism between the traditional and rural agricultural sector and urban and modern industrial sector is another example of structural rigidities (Srinivasan, 1988:p.5). Similarly, Lewis (1954) recommended the transfer of surplus labour from the traditional sector to the modern sector to increase savings and accumulation.

2.4.2 Centre-Periphery school[1]

In addition to the growth and modernisation theories, referred to within the Capital Scarcity school, the decades of 1950s and 1960s also saw the emergence of the Centre-Periphery school, particularly among the Latin American development economists. Because of the widespread pessimism about the prospects of exports, Prebisch (1950) argued that reliance on exports of food and raw materials in Latin America — the periphery — to the greater industrial centres would inevitably lead to a deterioration of Latin American's term of trade, which would further affect its domestic accumulation of capital. Similarly, the dualistic nature of the Latin American societies, consisting of one traditional agrarian, and one modernised urban society, provided a fresh departure in development theory: the ECLA school and the dependency approach.

[1] This school is sometimes called the Dependency school and according to Bloomstrom and Hettne (1984) represents, "the voices from the periphery" that challenge the intellectual hegemony from the American Modernisation school.

2.4.2.1 The Economic Commission of Latin America[1] (The ECLA)

Unlike the neo-classical economists who assured a smoothly working market price system, some of the early development economists — most prominently the Latin American structuralists like Raul Prebisch and Celso Furtado — attempted to identify specific rigidities, lags, uneven development, low elasticities of supply and demand, and other structural characteristics of the developing countries that affect economic adjustments and the choice of development policy (Chenery, 1975). In trying to find an explanation of the nature, causes and dynamics of the inequality between the producers and exporters of manufactured goods and the producers and exporters of primary commodities, Prebisch put special emphasis on the international economic relations, which he named the "Centre-Periphery" system (Prebisch, 1950). Convinced that the way forward lay in the transformation of domestic economic structures, the ECLA economists developed a new body of theory designed to explain that contrary to the principles of mainstream (neo-classical) international trade theory, the primary export orientation has been the basic reason why countries with this characteristic have remained underdeveloped. Prebisch divided the world economy into two broad groups of trading countries. The 'Centre' consists of industrialised developed countries which export manufactured goods and import primary products. The 'Periphery' comprises the developing countries which export primary products and import manufactures (*ibid.*).

The main aim of the Centre-Periphery school is to point to the non-applicability of the classical comparative theory of trade[2] to the development problems of less developed countries and to show that free trade between primary-exporting developing nations and

[1] The formulation of a distinctly Latin American school of development is intimately related to the ECLA which was organised in 1948 by the United Nations and was based in Santiago, Chile. In 1950, Prebisch was appointed executive secretary of ECLA (Meier and Seers, 1984:p.11).
[2] In following the dictates of comparative advantage, the classical theory of international trade assumes that all trading countries benefit, real income for the world is maximised, and the poor countries are "better-off" than they would be without trade. However, many economists (Prebisch, Singer, Myint, Myrdal), question whether the classical theory of trade is realistic for poor countries and whether it is relevant under dynamic conditions (Meier and Baldwin, 1957:pp.324-335).

the manufactures-exporting developed nations has actually worked against the development of the former.

Prebisch's strategy for Latin American development called for a change in the international division of labour and for Latin America to industrialise through import substitution. Initially domestic production was to be protected from foreign competition, but once competitive ability had been achieved, local firms should not be protected. The income earned from export of raw materials should be used to pay for imported capital goods, and thus increase the rate of economic growth.

> *From this analysis emerged the conclusion that import* substitution stimulated by a moderate and selective protection was an economically sound way to achieve certain desirable effects ... import substitution by protection counteracts the tendency toward the deterioration of the terms of trade, by avoiding the allocation of productive resources to primary export activities and diverting them instead to industrial production (Prebisch, 1984:p.179).

Therefore, Prebisch argued that the structural changes inherent in industrialisation require rationality and foresight in government policy. Planning was needed to help the rate of internal capital accumulation and to establish certain basic conditions for the adequate functioning of the market in the context of a dynamic economy *(ibid.:p.180)*.

The diagnosis of the Latin American situation by Prebisch and others including Singer (1950a and 1950b), Myint (1954), Lewis (1955) and Mydral (1956), (as cited in Meier and Baldwin, 1957:p.326) was based on the fact that while the type and extent of trade of each peripheral country with the centre depended largely on its resources, the international political economic relations enlarged the extent to which income was siphoned off by the centres. Such a pattern of trade had resulted in terms of trade moving secularly against the peripheral countries[1] and the technology from the centre in peripheral economies had penetrated mainly into activities connected with primary exports while the effects of international factor movements had not been entirely beneficial.

2.4.2.2 Dependency school[2]

The main proponents of this school[3] include P. Baran, A. G. Frank, T. Dos Santos and S. Amin, who analyse the conditions of underdevelopment and the process of development in ex-colonial (and semi-colonial) developing economies within the framework of Marx's critique of the capitalist system. The paradigm which the Marxian development economists have adopted differs from the non-neo-classical (orthodox) and neo-classical schools of development theory. Dependency theory went beyond economics in attempting to provide a general explanation of underdevelopment and the radical dependency theorists incorporated aspects of political economy in their analyses. They conceptualised dependency as a socio-economic and political phenomenon, which required a more complex view of the centre periphery relationship than espoused by the ECLA perspective (Hettne, 1990:p.88).

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[1] Prebisch (1950 and 1959), for example, had suggested that during the period 1870-1940 the trend of barter terms of trade had declined for the primary exporting countries at the average rate 0.9 per cent per annum. According to Thirwall and Bergevin (1985), during the post-war period, excepting the years 1971-74 and 1979-80, the terms of trade for non-oil primary products decreased at the annual (trend) rate of 1.2 per cent for the period 1954-72 and again at the rate of 2.5 per cent for the period 1973-82. In the case of Oman, as Appendix table 1 shows, its net barter terms of trade have declined from 210 in 1980 (1987 = 100) to 77 in 1995.

[2] As already mentioned we have treated the Dependency school within the broader grouping of Centre-Periphery school on the ground that the former also analyses the problems of LDCs in the context of international division of labour — based on trade and capital flows — between the primary producing and industrialised capitalist countries. In this view, the latter are dominant and the former are dependent upon the capitalist world which drains the surplus from developing economies through trade and investment.

[3] It should be admitted that a brief account may not correspond to the way this intellectual process actually was experienced by the founding fathers of dependency school. However, as Hettne (1990:p.82) indicates, this school emerged from the convergence of two major intellectual trends, one with its background in the Marxist tradition and its main theoretical orientation — neo-Marxism, the other rooted in the Latin American structuralist discussion on development which ultimately formed the CEPAL tradition (CEPAL is the Spanish term for ECLA).

A systematic and forceful analysis of the political economy of underdevelopment in the Marxian tradition was first presented in the early 1950s by P. Baran (1952). Although Baran did not work out any 'dependent' model of development in the LDCs, by theorising the principal causes of underdevelopment, he was seen as the founder of neo-Marxian and consequently to some extent the dependency school (Hettne, 1990).

Baran's main thesis is that the developing countries (Periphery) are underdeveloped and will continue to remain so as long as their economies are linked to the developed countries (Centre). Baran considers that the process of industrialisation in the LDCs is hostile or contradictory to the interests and needs of (former imperialist) developed countries. As Baran said "what is decisive is that economic development in underdeveloped countries is profoundly inimical to the dominant interests in the advanced capitalist countries" (Baran, 1957:p.28).

Because of the large number of contributors to the dependency school and their theoretical diversities, we will attempt to summarise their basic assumptions here, (Hettne, 1990:p.91 and Dube, 1988:pp.42-43); although, we will be examining some of the individual contributions in more detail later on.

- The most important obstacle to development are not lack of capital or entrepreneurial skills, but are found in the international division of labour.
- The international division of labour was analysed within the context of transfer of surplus from the periphery to the centre.
- Due to the fact that the periphery was deprived of its surplus, which the centre instead could utilise for development purposes, development in the centre somehow implied underdevelopment in the periphery. Thus development and underdevelopment could be described as two aspects of a single global process.
- Since the periphery was doomed to underdevelopment because of its linkage to the centre it was considered necessary to disassociate itself from the world market, to break the chains of surplus extraction, and to strive for national self reliance. In

order to make this possible more or less revolutionary political transformation was necessary. Politics would take command.

- International dualism within the world itself creates small centres of wealth and power while the periphery remains impoverished. International aid is an eye-wash. It feeds the Third World with false paradigms which are not intended to, and cannot, raise up the less developed — at any rate their masses — from backwardness.

Frank (1966; 1967; 1972; 1979) takes the dependency analysis further to explain the development of underdevelopment and predicts that under the capitalist world order, underdevelopment is likely to be a permanent feature of developing countries. He sees development and underdevelopment as two sides of the same coin, the former creating the latter.

According to Frank, the three factors leading to dependent development are: first, the countries in the periphery were incorporated into the world capitalist system from the times they were turned into 'exploited' economies during the colonial period (i.e. 5 to 10 decades prior to end of Second World War); second, the process which incorporated the (colonial) underdeveloped countries into the world capitalist system necessarily transformed them into capitalist systems i.e. systems based on production for profits via exchange or market mechanism; and lastly, this integration of LDCs into world capitalism was created through a "satellite-metropolis" dependency relationship[1] (Palma, 1978:pp.881-924).

Thus the 'satellite' economy's development is determined by forces external to its society, originating/derived from forces operating in the metropolis. In contrast, development of the metropolis is determined by forces internal to its own society. This asymmetry in the determinants of development creates an economic and exchange

[1] Terms used and preferred by Frank. These are same as Prebisch's Centre and Periphery. But Frank's terminology stresses clearly the element of 'dependence' in the relationship between the two groups of countries.

relationship in which the satellite is weak and dependent whereas the metropolis is strong and dominant. It is a relation of unequal economic power. It is clear from the above exposition that Frank rejects the 'dualism' model implicitly applied by other Marxists (Baran) to distinguish developed capitalist and underdeveloped pre-capitalist economies. He also rejects the policies put forward by the structuralists. For Frank, the only alternatives are either to break completely the metropolis-satellite nexus through social revolution or to continue to 'underdevelop' within it (Meier, 1989:p.106).

Frank's core idea of the "development of underdevelopment" is continued by Dos Santos:

> [d]ependence is a conditioning situation in which the economies of one group of countries are conditioned by the development and expansion of others. A relationship of interdependence between two or more economies or between such economies and the world trading system becomes a dependent relationship in which some countries can expand only as a reflection of the expansion of the dominant countries, which may have positive or negative effects on their immediate development (Dos Santos, 1970:pp.289-90).

Similarly, the views of Amin (1974) and Emmanuel (1972) emphasise that the dependence relation based on unequal power relations between the dominant developed countries and dependent underdeveloped countries takes the form of "unequal exchange". For Emmanuel this unequal exchange arises on account of the difference in the 'given' wages between the developed and underdeveloped countries. The workers in the LDCs are subjected to "double" exploitation of surplus value — by the capitalist countries' exploitative accumulation urge and the domestic capitalists' accumulative urge to extract surplus for their growth. Amin goes a step further and argues that not only there are wage differentials but these are larger than what would be justified by productivity differences.

The core of Amin's and Emmanuel's analyses is that the prices (terms) of exchange between dependent developing countries (periphery) and dominant developed countries (centre) are so determined, that the surplus is transferred mainly to the latter. This drain *of surplus out of the periphery further reduces the investible surplus internally available in* the LDCs which further increases the wage productivity differentials. This, in turn, gives rise to the continuing "unequal exchange" between the developed and underdeveloped countries.

2.4.2.3 Policy implications of the dependency school

Compared to the capital scarcity school, which assumes the lack of capital, savings and entrepreneurial skills as major obstacles to development, the dependency school rejects these as being the most important constraints to development. The dependency school thus sees the main obstacles to development to be located in the international division of labour and in the unequal economic exchange between the periphery and the centre. The dependency school is also regarded as a response to the failure of import substitution industrialisation (ISI) strategies proposed by the ECLA school.

The dependency school placed great significance on the role of the state in development. It suggested that peripheral countries should rely upon their own resources and plan their own paths of development to achieve autonomous national development, and that this process should be state-led. And in order to make this possible and overcome the opposition to change of local elites, social revolution might be necessary for a country to get rid of the old ruling elites. In the words of Chilcote and Edestein (1974:p.21) "Development requires the profound alteration of economic, social, and political relationships in the overthrow of the market and the mobilisation of domestic populations in a nationally oriented effort".

The dependency perspective has influenced development strategies at an international level. The New International Economic Order, for example, referred to in Chapter I, was also partly related to the influence of the dependency paradigm.

Dependency theory suffered a serious setback in the 1980s, not only because of the criticisms levelled against it by the liberal economists (Lal, 1985; Little, 1982) but also from analysts who are sympathetic, Lall (1975) for example, and from the dependency camp itself, for example Cardoso, (1974). Dependency theory is alleged to have been weakened by the transformation of the newly industrialised countries[1] into almost fully developed status[2]. This, it is claimed, shows that by adopting appropriate policies developing countries can overcome underdevelopment. Whereas the dependency theory argues that the world economy perpetuates underdevelopment from which the underdeveloped countries cannot escape[3].

2.4.3 Development theories for primary exporting countries

The theories and strategies, which we have discussed earlier, deal with the problems of underdevelopment and developing economies in general. However, there are theories which were formulated specifically for development of primary exporting countries[4]. These theories relate to the method by which economic rents from primary production are captured, and once captured, how should they be used. Then there is the

[1] These are the "four tigers" of East Asia viz. Hong Kong, Singapore, South Korea and Taiwan.

[2] Although it is premature to link the currency and stock market crises, that have rocked the Southeast Asian economies since July, 1997, to any one specific factor, but these recent experiences will perhaps prove that dependency perspective is as relevant today as it was in the 1960s.

[3] Some variations of the dependency or World Systems theories would suggest that individual countries such as South Korea and Taiwan constitute semi-peripheries between the core/metropolis and periphery/satellite countries. This is due to their privileged political relationship with the Western countries. And that this fact does not overturn the basic soundness of dependency theory. For the purpose of our thesis we need not dwell too much on this controversy. Suffice it to say that the role of the state has been crucial in securing whatever forms of development South Korea and Taiwan have secured.

[4] That is, countries which are economically dependent upon exports of primary products such as agricultural commodities, products of forestry, fishing, minerals and fuels (i.e. oil) mining. As we shall see in Chapters IV and V, a number of these theories are relevant for Oman in developing its oil mining sector.

question of the appropriate trade policy to be followed in exploiting the primary produce. Equally important is the issue of managing cyclical fluctuations — booms and depressions — in primary exports.

Keeping in view the obstacles to development faced by these primary exporting LDCs, in the 1950s and 1960s some leading development economists including Prebisch, Singer, Myint, Lewis, and Watkins presented theories which are specific to these primary exporting countries. The most prominent of these is the theory expounded by the 'structuralist' or ECLA school led by Prebisch and Singer and the dependency perspective advocated by Baran, Frank, Santos and Amin which we have already discussed earlier in this chapter under the Centre-Periphery school section. The two other relatively less well-known theories are briefly described as the "vent for surplus" theory of Myint (1958, 1964) and the "staple theory" which is associated with Watkins (1963) who wrote about Canada's economic development. The other theory which is strictly not a development theory but deals with problems specific to primary exporting countries is called the theory of Dutch disease syndrome.

Vent for Surplus Theory

Myint's "vent for surplus" theory of development for primary exporting countries keeps in view the background of rapid expansion of international trade during colonial era, i.e. from the late 18th century till the second World War. As a result of this trade, countries in Latin America, Africa and Asia (and the so called "empty" countries like Australia, USA and Canada), richly endowed with natural resources were exposed to new set of economic activities involving the use of foreign capital and management (and in many cases even labour) with local "land"[1] to produce goods which were in demand internationally and hence valuable but which were not consumed (or not fully consumed) in the home country. Therefore, such primary products (e.g. metals, oil, tea, coffee, rubber, jute, etc.) were in 'surplus' in relation to the non-existent or limited domestic

[1] Land in the wider sense of free gifts of nature.

demand and external trade provided a vent for this surplus. Since the primary production of these exportables brought in its wake foreign capital, technology, management and in many cases even immigrant labour, the growth of domestic production got linked, directly or indirectly, with this primary sector activity (Lewis Jr., 1989:p.1553).

The significance of this theory is that its application is confined not only to the colonial era but extends to the present day mineral exporting countries, particularly the petroleum exporting countries. Here the international movement of capital, management and labour seek to exploit a primary resource-based industry, the main market for which is not domestic but international. This industry, therefore, generates economic 'rents', in the sense that it involves the use of local primary resources, the opportunity cost (supply price) of which is very low (*ibid.*). The problem of development policy here is with regard to the management of these economic rents — whether to use these to raise present consumption or to invest it in development of non-primary activities, i.e. to diversify. A point we shall examine in detail, in relation to Oman, in Chapters IV and V.

Staple theory of development

While Myint's vent for surplus theory provides justification for a developing country's specialisation in primary exports, it does not fully explore the question of whether this activity devoted to providing vent for surplus, would result in sustained, long-term growth and development in the primary exporting country. The staple theory of development investigates the characteristics of the natural (primary) resource-based exports and its effects on the rest of the economy. Accordingly, the theory suggests that the developmental and growth impact of staple exports would depend upon the nature of technology used in primary exports (capital or labour intensive) and the linkages of export industry with the rest of the economy. The more labour-intensive (less capital intensive) the staple export production is, the greater would be the growth impact. As regards the linkage of staple export industry to the domestic economy, case studies of small petroleum exporting countries and of a copper mining economy showed that the linkage effects are low[1]. Therefore, the question, is whether these low linkages are inherent to production of staple exports or whether they arise on account of government policies. Secondly, even if direct linkages may be low, indirect linkages could be created, as has been done in Oman, through utilisation of economic rents from staple exports for investment in infrastructural and income-generating developmental projects. Of course, as we shall see, the move from indirect to direct linkages is not easy, and Oman has not completely been successful in developing the latter.

Dutch disease theory

The theory of Dutch[2] disease syndrome which deals with adverse effects of boom in primary export revenues has been propounded by Corden and Neary (1982).

In the Dutch disease model, the word "disease" is used to indicate that booming primary product exports, instead of stimulating development, actually damage the prospects for growth. The name of this model is derived from the fact that in Holland the rapid growth in natural gas in the 1970s actually led to rising inflation and declining share of manufactures in exports and output[3].

According to this theory the effect of booming primary exports on the tradables sector comprising agriculture and manufacturing, operates through the change in real exchange rate (RER).

The RER measures the real worth of (official) nominal exchange rate (NER) after adjusting the latter for relative inflation rates at home and in rest of the world. If domestic inflation rate is greater than world inflation rate then RER appreciates and vice versa. An

[1] These were the studies carried out in the 1960s by Seers on petroleum industry in small economies and by Baldwin on Northern Rhodesia (now Zambia) (as cited in Lewis Jr., *op. cit.*:p.1554).
[2] Named after the effect on Dutch industry in the 1970s, when the increase in natural gas prices and associated balance of payments surplus resulted in appreciation of the guilder (Lewis Jr., 1989:p.1562).
[3] Similar negative effects of boom in oil exports are believed to have occurred in Mexico, Nigeria and Saudi Arabia (Gillis, *et al.*:1992).

"appreciation" of RER discourages exports and makes imports cheaper. Depreciation of RER increases competitiveness of exports and makes imports costlier.

The rapid rise in primary exports leads to declining relative shares of agriculture and manufacturing industries because of a number of processes mentioned below:

- The RER appreciates with increased inflow of foreign currency. This is because either the NER appreciates if it is market-driven and allowed to float; or, if the NER is pegged and kept constant (like the Omani Rial to US Dollar rate), then money supply and domestic prices would increase. The appreciation in RER, on the one hand, discourages exports of agricultural and manufactured goods and, on the other, reduces profitability of the import-competing domestic production. Resources tend to flow out of the tradables sector with the result that relative shares of agriculture and manufacturing industries in national output tend to decline.
- The increased aggregate demand resulting from higher primary export incomes does not make agriculture and industry sectors more profitable because production of tradable goods have to counter actual or potential competition from imports, and the world prices of tradables do not change in response to higher demand in one country. Moreover, the appreciation in RER raises competitiveness of imports as they become relatively cheaper in real terms.
- Since the supply of non-tradable services (including labour) is less elastic (as these cannot be supplemented by imports), their prices rise as aggregate demand increases with rise in primary exports. This raises the costs of non-tradables purchased by the tradables sector. However, as we shall see in Chapters IV and V, in Oman the price of labour has not risen, despite increased demand, because of the government policy of employing expatriate labour.

For these reasons, booming primary exports result in slowing down the output growth of tradables and accelerates the growth of non-tradables. Consequently, the relative shares of agriculture and manufacturing decline and the share of services increases.

However, an important element in achieving successful structural change is the type of institutional arrangements formulated by primary exporting countries to manage the upswing and downswing of cyclical changes in primary exports. In the case of Oman, and as we shall discuss in Chapters IV and V, the setting up of the SGRF as an adjustment mechanism to manage the cyclical fluctuation in the price of oil greatly facilitated the development process.

2.4.4 Neo-classical school

As discussed in Chapter I, for most of the post-war period to the early 1970s, in most developing countries the state-led development strategy was the accepted paradigm to overcome the problems of underdevelopment. During this period the neo-classical, pro-market theories of development, especially in their simpler form, remained relatively dormant.

However, the 1980s saw what might be termed as 'counter-revolution' in development thinking. The neo-classical theory of growth — which was relatively marginalised for almost three decades — made a comeback with enormous consequences. A World Bank research publication of 1985 with the headlines: 'NEW RESEARCH PRIORITIES — THE WORLD HAS CHANGED — SO HAS THE BANK' (World Bank, 1985b) clearly reflected a shift in perception about the development process.

The emphasis on redistribution with growth and a direct attack on poverty which became a part of the Bank's strategy in the 1970s was almost forgotten. Instead the emphasis shifted to the benefits of the market mechanism and the 'rolling back' of the state. The neo-classicists held that efforts at comprehensive planning had failed and that liberalisation of foreign trade regimes had shown positive results in both growth and welfare (Little, 1982). These views and the strategies based on them have been already discussed in Chapter I.

In terms of the main components of the neo-classical economists' new vision of growth, Toye (1993:p.69) summarises them into three main groupings: firstly, the benefits of markets and the danger that government action will negate these benefits; secondly, the relative unimportance of physical capital compared with human development policies; and thirdly, the distorting effect of government policies.

The case for the neo-classical free market system rests not only on the ground of allocative efficiency; it also rests on the argument that state intervention is inherently inefficient, particularly in the developing countries. That is, the case for neo-classical resurgence also rests on the grounds of "government failure" as advocated in the public choice theory and theory of rent-seeking of Krueger (1974) and its extension in Bhagwati's (1982) theory of Directly Unproductive Activities (DUAs). We shall discuss these issues in Chapter III.

2.4.4.1 Advocates of neo-classical policy prescriptions for LDCs

The main proponents of the neo-classical restoration for solving the problems of developing economies have been, as we noted in Chapter I, the IMF, and the World Bank through their SAPs. Whilst economists like Bauer (1971), Krueger (1974), Little (1982), Bhagwati (1982), Lal (1985) etc., were its main theoretical ideologues.

As Toye notes,

> They are united in opposition to Keynes and neo-Keynesianism, 'structuralist' theories of development and the use of economic planning for development purposes. On the positive side, they are united by the belief that the problems of economic development can only be solved by an economic system with freely operating markets and a government that undertakes a minimum of functions. (Toye, 1993:p.vii).

On the basis of this overall negative perception of the state's role in economic affairs combined with optimistic perceptions of market forces working out "right prices" and Pareto-efficient resource allocation, the neo-classicals advocate withdrawal or rolling back of the state from those areas of economic activity which are best left to market mechanism, and minimising its role only to areas of market failure. As explained in Chapter I, using these propositions of neo-classical policy prescriptions, the World Bank advises the LDCs to follow 'market-friendly' development strategy (World Bank, 1991a:pp.5-11). However, it will be noticed from our analysis in Chapter III that the market-friendly approach to development as advised to the LDCs by the World Bank provides for a role of the state which is much wider than that suggested in neo-classical economics.

2.4.5 Development theories and strategies recommended in development policies : an overview

The three main schools of development thought encompass a number of development strategies which include one or more aspects of a determinate number of issues. These are briefly stated below:

a) To accelerate the growth of physical capital formation by simultaneous and *balanced growth* of several industries linked by complementarity of their markets.

b) To accelerate the rate of investment in physical capital through concentrated investment in selected *social overhead capital* or *directly productive activity* so that the resultant *unbalanced growth* creates conditions favourable for induced investment through forward or backward linkage effects.

c) To accelerate the rate of accumulation by using a particular sector or industry as the *lead sector* so that investment in follower sectors would be induced.

d) To promote *import-substituting industries* to overcome the problem of adverse terms of trade arising on account of heavy reliance on primary exports and imports of manufactures from developed countries.

e) To increase investment, employment and productivity of a modern, capitalist sector using a perfectly elastic supply of disguised unemployed and under-employed labour i.e. subsistence agriculture.

f) To directly attack the problem of widespread human deprivation and absolute poverty by *providing basic needs* to the whole population.

g) To liberate underdeveloped economies from their dependence upon exploitative capitalist, developed countries through a socialist revolution.

h) To make state policies 'market-friendly' by creating institutions, environment and conditions favourable for private investment ensuring efficient functioning of markets and promoting free trade by following the principle of comparative cost advantage.

With the exception of the neo-classical school, both the Capital Scarcity and the Centre-Periphery schools advocated a major role for the state in implementing these strategies. The extent of that role depended on the initial conditions in each country. Moreover, such a role, as we shall see in the case of Oman, is not static. It evolves in its scope, method, and intensity with each stage of development.

In this context, Byres's (1994:pp.12-33) analysis of development planning in India suggests that capitalist transformation entails the development of productive forces (technology, and other inputs). This, in turn, requires an acceleration and intensification of the process of capital accumulation on a larger scale. The state's intervention is therefore potentially critical, since the state may act in a variety of critical ways: as an agent of technical change, in its fiscal role, as an arbiter and setter of prices, and so on. Moreover, a state intent upon capitalist transformation must, on given conditions, act as a promoter of change, as a creator of a large public sector; must initiate accumulation in its own name; and must decide upon the pattern of that accumulation.

Within the neo-classical school, a greater emphasis is placed on the role of the market in development; but a free, competitive market is a 'public good'[1] and needs to be developed and regulated by the state as well. In this sense the neo-classicists have a rather restricted understanding of the market. The latter could never exist without the state providing public goods such as infrastructure, legal framework (to protect property and contracts), communication of information, etc.

2.5 Development Theories and Strategies in Oman's Development Experience

Oman has promoted accelerated development by following a well-co-ordinated combination of several of the strategies mentioned in section 2.4 of this chapter.

In developing its primary resource, oil, Oman relied on the principles of free trade and comparative cost advantage, as is suggested by the classical and neo-classical thinkers. It did not adopt the policies of import-substituting industrialisation proposed by the Centre-Periphery school. Nor did Oman look at the oil multinationals[2] in an antagonistic way as is suggested by the Dependency approach. These pragmatic policies, as we shall see in Chapters IV and V, were suited to Oman's specific circumstances prevailing at that

[1] Because its use by one player does not preclude its use by another to any lesser extent.
[2] Appendix 2-AI provides background information regarding Oman's policy towards oil companies.

time, and enabled Oman to achieve the twin objectives of economic and social development. Using the oil sector as Rostow's (1960) "leading sector" the state in Oman launched a large scale public investment programme to diversify the economy and develop the market mechanism, and, at the same time, it was able to increase both production and reserves of oil during the period 1976-95.

During the First and Second FYPs (1976-1985), Oman followed the 'unbalanced' growth strategy by concentrating a major proportion of the non-oil sector investment in what Hirschman (1958) and Rosenstein-Rodan (1984) described as Social Overhead Capital. That is, in the creation of social and economic infrastructures consisting of education, health, housing, roads, electricity, water supply and telecommunication network. Only a small proportion of non-oil investment had been devoted to what Rosenstein-Rodan and Hirschman called Directly Productive Activity such as (non-oil) manufacturing industries, agriculture and fisheries[1] (*ibid.*). Similarly, in terms of regional development, an unbalanced strategy was adopted during the first two plans. As a result, the main thrust of development was concentrated in the capital area in the initial stages. This was done to remove a number of immediate bottlenecks, so that a more sectorally and regionally balanced strategy of development can be followed in subsequent plans.

On account of the near-complete economic stagnation that prevailed in Oman during the pre-1970 period, the supply of private entrepreneurship was quite scarce in Oman during the first decade of development planning — 1976 to 1985. Hence the state had to play the role of Schumpeterian entrepreneur by setting up a number of wholly or partly owned enterprises for production of cement, copper, flour and petroleum refined products, as we shall see in Chapters V and VI.

[1] This was not because of any intentional neglect of these sectors, but by investing in SOC the government was creating/providing positive linkages for the development of these sectors. Moreover, in line with the long-term development strategy, these were the sectors where the private sector involvement was predominant.

However from the Third and Fourth FYP onwards (1986-95), Oman shifted towards a balanced growth strategy by giving priority to balanced regional development and growth of directly productive activities or goods producing sectors. The share of non-oil sector in GDP (at current prices) has grown from 41 per cent to 63 per cent between 1976 and 1995 and the combined share of agriculture, fisheries, non-oil mining and manufacturing increased from 2.6 per cent to 7.8 per cent during the same period (Oman, 1986b, and 1996b).

On the lines suggested by the "basic needs" strategy, substantial investment in social and economic infrastructure was aimed at directly approaching the problem of enhancing human development, instead of waiting for the working out of the 'trickle down' mechanism. As Appendix table 1 in the Introduction to the thesis shows, this direct approach significantly improved life expectancy, substantially reduced infant mortality and dramatically expanded school enrolment. Although income distribution and poverty data for Oman are not available, the rapid growth in per capita income combined with equally rapid expansion in health and education, and supply of public utilities like electricity, water, transport and housing should have reduced both inequalities and absolute poverty.

In the sphere of foreign trade, following the neo-classical trade theory, it has kept its domestic market almost completely open to imports of all types of manufactured goods[1]. At the same time, without creating quota based protectionist barriers, it has also promoted import substituting industries such as cement, food processing, packaging, printing and stationery etc. through incentive-based promotion of private sector investment in these areas. Thus the domestic producers in these areas have to compete with imported goods (see Chapter VII).

In private sector investment, as we shall see in Chapters V and VI, the state's attitude is more promotional than regulatory; the restrictions, where they exist, relate

[1] However, as we shall argue in Chapter VII, such a policy has not been very conducive for diversification, and perhaps a more focused state-led industrial policy is warranted to achieve the diversification of the economy.

mainly to standards of quality and safety. In short, the state policy aims to use development planning to develop a competitive and free market. Thus Oman's development planning has managed to strike a balance between capital formation and consumption, economic growth and human development, openness and import-substitution, state intervention and market-based development.

However, development is a continuous and dynamic process and strategies have to be continuously reviewed and redefined as understanding of the process deepens and as new problems to be solved by 'development' emerge. As Streeten, (1978:p.34) has observed, there is a solution to every problem but also a problem to every solution. Therefore, based on the experiences gained over the last two decades, the New Development Strategy proposed in Oman call for a change in emphasis. As we shall see in Chapter VII, these call for a more proactive role for the state in achieving diversification and human resources development, while at the same time, aim towards fostering a dynamic and efficient private sector.

2.6 Conclusion

This chapter has shown that although development economics has been among the oldest branches of economics from the days of Adam Smith, it was not until after the Second World War that a renewed interest in the sub-discipline evolved.

Therefore, to address the problems of poverty and backwardness, the pioneers in development economics including Rosenstein-Rodan, Nurkse, Hirschman, Prebisch, Lewis etc. had to conceptualise, deduce principles, build models and delineate strategies of development to overcome the many obstacles to development.

Some of their ideas on development were derived from the five major groups of theories: the classical economics of Adam Smith and Ricardo; the Marxian perspective; the neo-classical and Schumpeterian analyses; and the Keynesian macroeconomics.

We have also shown how development economics and development theory evolved in the post-war II period in response to the needs of the newly independent developing countries. In our attempt to classify the major schools of development theories and strategies, we identified three main schools: Capital Scarcity; Centre-Periphery; and the Neo-classical. Moreover, since oil export revenues have been the principal source of finance for Oman's development, we have also provided the context of theories specifically dealing with development of primary exporting countries and noted that these theories are relevant to Oman. We also argued that development, as a concept, has always been strongly associated with the state, and with national development strategies. And since the theories and strategies advocated by the first two schools were more relevant to the conditions prevailing in the developing countries, these two schools formed the basis of most of the development process during the three decades following the end of the Second-War.

The theories and strategies described in this chapter provided an inventory from which Oman could draw its own policies and strategies of development in a pragmatic manner and in relation to its economic and social conditions. This necessitated the state taking a leading role in the development process including nurturing the private sector and developing the market. In this sense Oman's strategies and policies of development were a synthesis of different approaches that we have described in this chapter. The exact nature of the synthesis depended on the specific problems that Oman had to confront at a particular time. We analyse these issues in Chapters III, IV and V in particular.

Appendix 2-AI

Oman's Policy Towards Oil Companies

Oman has never been a member of the Organisation of Petroleum Exporting Countries. In dealing with the foreign oil companies engaged in oil exploration and extraction, Oman has followed its own independent policy. Accordingly, it has followed OPEC actions only when its national interests required it to do so. While some OPEC members like Iran, Iraq, Kuwait and Algeria nationalised their oil industry in the early 1970s (Findlay, 1994:p.79) the Oman government, by an agreement in 1974, acquired a 60 per cent share in PDO and established a joint management committee to oversee the operations of the joint venture (Al Yousef, 1995:p.27). Thus, in relation to the foreign partners of PDO[1] and other foreign oil companies engaged in oil exploration and extraction, Oman's policy had two objectives: (a) to acquire, through negotiations, a significant share in the oil operation that would enable it to influence the exploration and production policy; and (b) to provide the foreign shareholders with sufficient incentives to invest capital and introduce latest technology for the development of new and existing oil reserves[2].

Appendix 2-AI contd...

[1] Presently, oil in Oman is extracted mainly, though not wholly, by a joint venture company called the Petroleum Development (Oman) Ltd. PDO is jointly owned by the Government of Oman (60 per cent), Royal Dutch Shell (34 per cent) Compagnie Francaise des Petroles (4 per cent) and PARTEX (2 per cent). PDO accounts for 94 per cent of the total extraction. The rest is extracted by three foreign companies viz. Elf Acquitaine (ELF), Occidental Group (OXY) and Japan Petroleum Exploration Co. (JAPEX). Oil produced by PDO, is distributed among its partners on the basis of their respective shares in its ownership (Oman, 1996b:p.189).

[2] This approach was in the line with the neo-classical interpretations of multinationals' and their role in the economic development of Third World countries (Jenkins,1987). It is based on the assumption that foreign capital is complementary to local capital rather than displacing it, and that increasing competition between multinationals from different origins has increased the bargaining power of Third world countries. The retention of foreign shareholders is expected to provide the host country not only with the latest state-of-the-art technology, but also with a sharing of risks, foreign capital, management expertise and the comfort that all new investments would be subject to a thorough cost-benefit analysis.

Oman government's pragmatic policy towards foreign oil companies has not only contributed to a large increase in oil reserves and production but also allowed it to influence their activities. In fact, the take-over of decision-making by the government was also a crucial development. By virtue of the 1974 agreement the government was able for the first time to influence — to the extent possible — the exploration and production activities of PDO.

The agreement signed in May 1977 between the government and the foreign partners of PDO, was designed to provide an incentive to the foreign partners to develop the southern oil fields. The agreement had three main elements: an accelerated depreciation of the foreign partners' assets (all investments were to be depreciated at 40 per cent in the first year, 30 per cent in the second year and 10 per cent in each of the next three years); a guaranteed income to the foreign partners (net of operation costs and depreciation), of US$ 0.23, per barrel on all the oil produced, indexed to the buy-back price of Omani crude; and a return of 7.5 per cent on their share of PDO's average assets (Al Yousef, 1995:p.31).

Another important factor in the development of the oil sector was the agreement reached with the foreign shareholders of PDO in March 1986 whereby it was agreed that effective from 1 January 1986 the government would pay the private shareholders of PDO a fee, net of Omani income tax, of 40 US cents per barrel of the increase in the Expected Ultimate Recovery in each year (Al Yousef, 1995:p.33).

The logic of this agreement was to provide an added incentive to the foreign shareholders to make experience, technology and know-how available so that PDO could conduct an intensive programme of exploration and also conduct appraisal/appreciation of oil reserves of PDO. The underlying objective was to increase the oil reserves of PDO, in particular through exploration, and thus to increase the Expected Ultimate Recovery.

CHAPTER III

PLAN AND MARKET IN DEVELOPMENT : A THEORETICAL AND EMPIRICAL ANALYSIS

"In rejecting Lenin it is not necessary to embrace Milton Friedman" — *Boston Globe*[1]

3.1 Introduction

The aim of this chapter is to provide a more concrete level of analysis of some of the major issues that comprise the problem of plan and market in development. The analysis is comparative and theoretically levelled at the 'middle range[2]' for this will allow us to bring comparative experience from a number of selected countries. This chapter also lays the framework for a concrete analysis of the role of the state and market in Oman's development in Chapter VI. Of course the issues discussed in this chapter follow from the theories and policies, not to mention the debates, that we have analysed in the previous chapter. In other words this chapter also concretises the issues we discussed in more abstract terms in Chapter II.

The chapter provides an analysis of the complexity of elements that constitute planning, including the concepts and definition of planning, and the levels and types of planning. It then discusses the way planning has worked in practice by drawing on the experiences of five selected countries, China, India, Japan, South Korea and Oman. Thereafter, it takes up briefly the arguments put forward by some proponents of market-led development strategies and the various issues in the plan versus market as they relate to developing countries.

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[1] As quoted in Nove, A. (1992).

[2] By middle range we mean a level of theoretical analysis which can be connected to the empirical phenomenon being analysed. That is, a level which is both more concrete and observable and around which strategies and policies can be formulated to effect an outcome.

This chapter shows that all developing countries, including the East Asian, have incorporated systematic use of market mechanism and planning in promoting economic development, and that the state has fostered and sustained the market where this has been weak or absent. Thus the market and state do not work in isolation. Of course, development is a dynamic process, and it needs an appropriate and dynamic approach. And almost all developing countries pass through a number of stages (but not necessarily schematically or in a uni-linear manner), because the degree of state involvement varies from one stage to another. The degree and quality of involvement depends on the tasks the state has to perform, from regulator of the economy to promoter of market and private enterprise and from provider of basic infrastructure to meeting basic needs.

The chapter concludes that the case for rolling back the state in developing countries is very weak because the roles that the state and markets play are complementary and not conflicting, given the specific conditions prevailing in these countries. The combination of the state and markets is larger than the sum of its parts; so that more can be achieved by their working together than by each working separately; and that co-operation rather than conflict between the two entities is more likely to assure success in securing development.

3.2 Plan and Market in Development : A Comparative Analysis

Although available data in table 3.1 below provide no support for the proposition that a higher share of government in national income is detrimental to economic performance, yet the "rolling back" of the state and a free market is deemed to be a cure for all diseases. For example, during 1980-93, with an average share of central[1] government expenditure around 17 per cent of GNP, both South Korea and Thailand achieved an average annual GDP growth of 9.1 and 8.2 per cent, respectively. Whereas

[1] Central government expenditure comprises the expenditure by all government offices, departments, establishments, and other bodies that are agencies or instruments of the central authority of a country. It includes both current and capital (development) expenditure (World Bank, 1995a:p.235).

during this period, both Mexico and the Philippines with a similar share of government expenditure of GNP, achieved an average annual growth of 1.6 per cent and 1.4 per cent respectively. On the other hand, United Arab Emirates, with an even lower ratio of government expenditure to GNP, experienced an average annual growth rate of 0.3 per cent. Oman, with the highest share of government expenditure in GNP, achieved an average annual growth of 7.6 per cent, and Botswana which had the second highest share of government expenditure to GNP after Oman, achieved the highest average annual growth rate of 9.6 per cent of GDP. Thus there seems to be little substance in the argument that growth rate of GDP is inversely related to the share of government expenditure which is taken as an indicator of the state's involvement in economic activities.

Table 3.1

GDP growth and central government expenditure (1980-93) : Oman compared with selected countries

Country	**Average annual growth (%) of GDP**	**Central Government expenditure as % of GNP[a]**
Botswana	9.6	38.3
South Korea	9.1	17.3
Thailand	8.2	17.5
Oman	7.6	53.5
Malaysia	6.2	28.1
Indonesia	5.8	21.0
Chile	5.1	26.3
Israel	4.1	31.1
Mexico	1.6	17.4[b]
Philippines	1.4	16.7
United Arab Emirates	0.3	11.5[b]
Trinidad and Tobago	-3.6	32.0[b]

Note:

a) Calculated as a simple average of the years 1980 and 1993.

b) Data for 1980 only, data for 1993 not available.

Source: World Bank (1995a) *World Development Report 1995*, pp.164-165 and 180-181.

Colclough (1991a:p.16) also shows that there is no evidence to support the notion that a reduction in public expenditure would accelerate growth, "[t]here is no apparent relationship between GDP growth rates achieved and the proportional importance of public spending" (*ibid.*). Conversely, the results of the study carried out by Ram (1986), indicate that the size of government expenditure is positively associated with economic growth performance in a range of countries across the world. This is so in the overwhelming majority of country cases, especially in developing countries.

A careful analysis shows that the roles of states and markets in fostering economic efficiency are clearly intertwined in the sense that they are mutually reinforcing and both are dependent on each other. For instance, as we have shown in the two previous chapters, the development so often cited as convincing proof of the efficiency of the market — the success of the East Asian economies and the collapse of Communism and Socialism in Eastern Europe — actually provide the justification for the role of the state. As Commack argues, a capacity for effective intervention on the part of the state is as much a requirement for the pursuit of liberal economic policies as it is for intervention aimed at resisting the pressure of market forces. In the case of Latin America[1], for example, Commack argues that "[W]here a policy of active intervention has been abandoned as a failure, this has not led to a process of reform which has strengthened the capacity of the state to promote alternative liberal policies any more effectively" (Commack, 1991:p.153).

Equally important is the fact that developing countries, in constructing their respective paths to social and economic development, pass through certain phases, as we shall see when we analyse Oman's development in Chapters IV to VI. These phases are

[1] For example, the modified shift to liberal policies in East Asia was preceded by substantial reforms imposed by strongly interventionist states, which created the conditions for international competitiveness. While in the case of Latin America, because the shift is being made from a position of weakness, reforms have faltered. Both land reform and fiscal reform have generally been avoided, and academic commentators have generally advocated the postponement of social and economic reform, including measures for redistribution of income. The basic difference between the two lies in the ability of the state to direct the accumulation process in the direction which is required by capitalist development at particular points in time (Commack, 1991:p.152).

determined by the conditions prevailing when the development process is initiated; but are also strongly influenced by the volume of resources available, the organisational and institutional arrangements existing at that time to put these to use and the prevailing international political economy. The policy framework (strategy) is also crucial which is dependent on a number of factors including those just mentioned.

However, as Byres (1994:pp.7-8) argues in his support of planning in India, any assessment of the need for planning or otherwise, or the success or failure of planning, must be seen within an historical perspective. Such an assessment must be carried out in two overlapping senses: an analytical-political economy sense; and a chronological-political economy sense. In the analytical-political economy sense, development planning must be understood with respect to the 'laws of motion', or 'tendencies', which mediate the social formation (in a country) and their attendant contradictions, especially as they relate to *accumulation* and the *sources of accumulation;* secondly, the instrumentality of development planning must be assessed in relation to the possibility of transition from economic backwardness to a more developed mode of production; and thirdly, the historical time within which one must operate, if the treatment is to be adequate, is, at one level, that of the *longue durée*[1].

The chronological-political economy dimension has three requirements. The first is a careful account of the sequence in which particular institutions were set up, and by whom. The second is a treatment of the manner in which *plan formulation* and *planning techniques* have proceeded and evolved. And the third is an examination of the unfolding of the historical experience of the vicissitudes of plan implementation in all their variety.

A full assessment of planning experiences in either the analytical-political economy or in the chronological-political sense is not within the scope of our research, and since definitive generalisation on the role of the plan versus market in development may be

[1] This has been described as 'the least perceptible, and in a sense, the slowest of all forms of historical time ... (whose) effectivity is staggered across centuries, and (whose) reality (is) only measured on that scale' (Banaji, 1977:p.27, as cited in Byres, 1994:p.7).

difficult to sustain, there is compelling evidence to support the necessity of a mix of public and private activities. Therefore, we shall concentrate our discussion of the main issues in the debate within the context of the theories and strategies of development outlined in Chapter II.

These issues are: firstly, the presumed superiority (or inferiority) of the 'invisible hand' of the market over the 'visible' arm of the government to maximise social welfare[1]; secondly, the efficacy or otherwise of invisible controls of the market mechanism over the visible controls of state administered planning, in co-ordinating and reconciling conflicting individual self interests for achieving the goals of economic and social development[2]; thirdly, the appropriate role for government in macroeconomic management in the era of globalisation[3]; and fourthly, the quantity and quality of activity to be undertaken by the market and/or the state. To put it succinctly, what should be the role of the state in developing countries in the contemporary international economy, and the appropriate level of public/private sector interaction[4]?

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[1] The question of whether consumption, production, distribution and prices ought to be regulated to maximise social welfare is not the point at issue in this debate. Nor is the case of the proponents of state led planning that leaving the functioning of an economy to free play of market forces would lead to anarchy and abandonment of the goal of social welfare. In fact both market mechanism and planning are advocated as instruments to attain maximum social welfare.

[2] As set out in Chapter II.

[3] For the neo-liberals, the rise of globalisation realises the ideals of mid-twentieth century free-trade liberals like Cobden and Bright, and means the end of the Keynesian era. While the dominance of volatile, international markets, the change to flexible methods of production and the radical reshaping of the labour force have made states less autonomous and reduced the centrality of national political process (Hirst and Thompson, 1996:pp.176-178).

[4]The *World Development Report* (1996:pp.110-111) similarly listed four groups of goods and services that have features which tend to make private markets fail, or function inefficiently, creating a potential for government intervention. These are: (i) Pure public goods such as defence, law and order and environment protection; (ii) Goods with positive externalities, or spillover benefits, such as education and health which are worth more to society than to one consumer; (iii) Natural monopolies such as gas pipelines, local transport and other infrastructure, where unconstrained monopoly producers tend to overprice and undersupply these services; and (iv) Imperfect information, on the part of either consumers or providers, may make markets fail. Private commercial insurance, for example, cannot effectively insure against risks like unemployment, longevity, etc., because these risks are influenced by characteristics and behaviour of the insured that the insurer cannot observe, along with government policy, and they affect large parts of the population equally and simultaneously.

Implicit in the issues raised is that in no country has development been secured completely by market mechanism or completely by state controls and planning. Even in the case of to-day's developed market economies, during the second half of the 19th and the first half of the 20th century, the usual pattern of development was a mixture of the state providing (implicit or explicit) directions to the development process[1]; thereby creating the conditions in which private entrepreneurs could operate (Johnson, 1989:p.516). According to Johnson (*ibid.*), the plan versus market debate pertains only to the question of which institutional mechanism is best suited to regulate the functioning of the microeconomy within the broad framework of developmental goals set out explicitly or implicitly by the state.

3.3 The Relevance of Planning

There are a number of issues that need to be clarified that relate to the effectiveness of Planning. These have implications for our study. These issues include, for example, the extent to which planning has or does not have an effect on an actual economy. The contention is that it is the system or structure of a country that is the main determinant of an economy, and that policy and planning are marginal to the goals and objectives attained in an economy.

The second issue relates to the size of a country as the main determinant of social and economic development, and not policies or planning. It may be contended that planning in Oman has been effective because it is a small country with a small population of about 2 million.

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[1] In the twentieth century, for example, states acquired the means to manage or direct national economies, either through autarchy and state planning, as was the case with state-directed economies in Britain and Germany in the two world wars, or through Keynesian measures using monetary and fiscal policy to influence the decision of economic actors and thus alter economic outcomes (Hirst and Thompson, 1996:pp.174-175). Thus in the advanced Western industrial states it was widely believed that national economic management could continue to ensure both full employment and relatively steady growth. In these societies, in which the majority of the population remained manual workers even into the 1960s, uniform national services in health, education and welfare remained popular.

The third contention is that countries with a valuable resource such as oil will achieve development as a result of this resource and that policies and planning are marginal to this development. Hence, it may be contended that Oman has oil, and therefore its economic and social development is determined by this fact and that policies and planning in Oman are marginal to its development.

If the system or structure of an economy, rather than policies or planning were the more important determinants, then we would find Latin American countries — with weak planning and policies for most part of their modern history — to be at the forefront of economic and social development.

In fact, one finds extremes of poverty and structural dislocation (debt, capital flight, etc.) in some of the resource-rich countries such as Mexico, Brazil, Venezuela and Colombia (Gilbert, 1990).

The impact that policy and planning can have on economic and social development is illustrated by the case of Sri Lanka. In the 1960s and 1970s, this country had a per capita GNP which was not too dissimilar to that of India or Pakistan. Whilst the latter countries had a life expectancy of about 52 years, Sri Lanka's approached 70. In fact, life expectancy in Sri Lanka rose from 43 years in 1946 to 67 years in 1980. In the same period, infant mortality declined from 141 to 39 per thousand live births (Gutkind, 1988:p.140). According to the *Human Development Report 1993* (UNDP, 1993), in 1990 India had per capita income of US$ 360 and life expectancy at birth of 59 years; Pakistan with a per capita income of US$ 400 had a life expectancy of 58 years and Sri Lanka[1] with a per capita income of US$ 470 had life expectancy of 71 years.

The results in Sri Lankan development are better compared to Pakistan and India because of the systematic application of basic needs policies. Clearly, policies and

[1] In fact, Sri Lanka's rank of 86 in Human Development Index in 1990, among the 173 countries listed in the Human Development Report of 1993, was 44 ranks higher than its GNP per capita rank (*ibid.*:pp.135-136).

planning do have an impact on social and economic processes. It is most unlikely that Sri Lanka with a lower per capita GNP (in the 1960s and 1970s) than Pakistan and India would have achieved more favourable results than these countries without effective planning (Gutkind, 1988).

Regarding the size of a country — if this was the major determinant of development, i.e. that a smaller country is better equipped to develop than a large one — then one would find India achieving greater development than China, which has a larger population than India. In fact as we shall see later one finds China's development performance exceeding India's in almost every economic and social indicator.

The third contention regarding resources is weak. If resources alone were the main determinants of economic and social development then one would find some African countries such as Nigeria and Gabon at the forefront of development. But this is not the case. Even more than African countries one would expect Brazil and Mexico, possessing a variety of valuable resources (oil, minerals, forests, etc.), to be at the forefront of economic and social development. In fact, as we have mentioned above, the resource-rich Latin American countries are beset by numerous structural problems in their economy which are reflected in, for example, great social inequality and poverty (Gilbert, 1990).

Hence, Oman's success in economic and social development cannot be simply attributed to oil or size of population. As we shall see in Chapter V, without planning, Oman would not have been able to carry out a successful structural adjustment programme in the wake of the oil price collapse in 1986, without the interference of the IFIs. Effective policies, strategies and planning have been crucial in enabling Oman to achieve a far superior performance in economic and social development, especially during the period 1980-90[1], compared to a number of other oil exporting countries.

[1] This was the period when oil prices started their decline and a number of oil exporting developing countries among other countries, had to undertake SAPs under the supervision of the IFIs.

3.4 Arguments for State Intervention through Planning

There are two types of state intervention that shape the process of economic development. The state may intervene in economic affairs on an ad hoc basis to deal with particular problems and cases of market failure. Alternatively, the purpose of state intervention may be to implement a plan of development covering the whole or a large part of the economy as has been the case, for example in Oman, China, India and the East Asian economies. Many instances of the former type of state intervention are found in the history of economic development of USA, UK, Germany and other developed market economies[1]. State intervention through planning relates to actions and policies of governments to attain, within a given time-frame, certain pre-determined objectives and targets of economic development. State intervention in the socialist economies (China, Cuba, Vietnam, the former USSR[2] and East European countries) and in the developing mixed economies of Asia, Africa and Latin America belong to this second category.

In the post-war period, development planning was adopted as a means for overcoming obstacles to development and for ensuring systematic economic growth at high and constant rates. The theories and strategies of development discussed in Chapter II provided the assumptions, tools and mechanisms for such activity. Moreover, this activity was encouraged by the United Nations, the World Bank and foreign aid donors (Waterston, 1982:p.44).

As we shall see in the next section, the kind of planning a country adopts is dependent on its political, social and economic context as well as its stage of development.

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[1] For instance, the series of legislative and administrative actions taken under "New Deal" by the government in USA during 1933-37 to deal with the problems thrown up by the great depression of the 1930s. Similarly in the 1930s, the British government provided price support to agriculture, imposed import quotas on meat products and encouraged, by specific legislation, cartel arrangements in the coal industry (Meier and Baldwin, 1957:pp.462-472). Likewise, Waterston (1982:p.40) states that in Germany several state governments already engage in planning and the Federal Ministries of Transport, Post offices and Health have each prepared multi annual investment programmes in their fields of activity.

[2] Union of Soviet Socialist Republics (Soviet Russia).

Also, because of differences in these concepts in developing countries, the scope of development planning varies accordingly. Thus, we shall see in section 3.5 that development plans range from the limited and piecemeal, project by project approach found in mixed economies in early phases of development, to the comprehensive, centralised planning found in socialised economies. Similarly, the scope and content of state intervention and market processes also change with each stage of development.

3.4.1 Case for development planning and state intervention[1]

The proponents of state intervention in economic processes in general, and for securing development in particular, describe the conditions which necessitate intervention. The main instrument of this intervention is development planning which concretises and puts into operation economic development policies. Some of the issues involving state intervention are identified below.

Firstly, *the importance of a strong state* — As we have noted earlier, the state has an important role to play in social and economic change. However, the perceived or actual need of governments to take care of things by across-the-board interventions will, of course, differ markedly across time and space. It is the strong role played by the state which has led to the success of the East Asian economies. Whereas the "softness" of the states is blamed by Myrdal for failure to implement declared policy goals of socio-economic development (Myrdal, 1968). Even the World Bank has started to realise the importance of capable state institutions for implementing good economic policies (World Bank, 1997a).

Secondly, c*ompetitive market as a public good* — Streeten (1995) argues that the free, competitive market is a public good. There are indeed several ways in which government intervention can contribute to a better functioning of the market. In addition

[1] Based on Lewis, 1951 and 1966; Grossman, 1974; Rosenstein-Rodan, 1955 and 1984; Hirschman, 1981; Urrutia and Yukawa, 1988 and Chakravarty, 1991.

to providing a framework for regulation and promotion of private sector activity, in terms of enforcement of contracts, property rights, anti-monopoly laws, the government can, in certain cases, by getting prices "wrong"[1] achieve the desired objectives of efficiency. In Oman, for example, as we describe in Chapter IV, the government policy of pricing crude oil to the domestic refinery at a price exceeding the international oil price[2] was able to achieve a number of development objectives.

Thirdly, *complementarity of public and private investment* — Government intervention has also been blamed for "crowding-out" private sector investment. However, it has been proved that government investment in roads, ports and industrial estates has actually stimulated private investment. For instance, in Oman, the government has encouraged the private sector to set up many industrial projects by establishing a number of modern industrial estates. The same has been the case, throughout the semi-industrial world (Taylor, 1994:p.75).

Fourthly, *state intervention to overcome market failures* — A principal justification for public policy intervention lies in the frequent and numerous shortcomings of market outcomes. Although Lal (1985) for example, considers all development economics to be misguided because it advocates a role for government in overcoming market failure, Myrdal, (1968) sees the absence of intervention as inevitably causing systems to deviate from both growth and equity because of the prevalence of market failures. However, even the World Bank supports government intervention to rectify market failures (World Bank, 1991a; 1996).

Fifthly, in many developing economies, the market is relatively undeveloped or highly imperfect in some important sectors, for example, in subsistence agriculture,

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[1] This has been the case in all late-industrialising countries, "states have intervened to get prices "wrong" because initially firms could not compete even in labour-intensive industries on the basis of low wages" (Amsden, 1992:p.61).

[2] About half of the crude oil supplied to the refinery is being charged at a fixed price of US$ 30 per barrel, while the other half, is charged at export prices charged for other buyers of Omani crude oil. See for more details Chapter IV.

traditional small industries, finance, labour, etc. Here state intervention operates as a surrogate market by intervening through allocation of resources, pricing, and so on. Hence the concepts of market failure, particularly of externalities and public goods, acquire much wider meaning. For example, government subsidies or direct provision are justified in education and technology — because they yield positive externalities (benefits) for society at large in addition to the benefits derived by the recipients; in increasing returns industries — markets will fail to generate efficient outcomes where production is subject to increasing returns (falling marginal costs), e.g. public utilities[1], "[T]he provision of such "overhead costs" for the economy as a whole requires a large minimum size of investment in each infrastructure project and an irreducible minimum industry mix of different public utilities" (Rosenstein-Rodan, 1984:p.214). In promoting distributional equity, it is well acknowledged, that the distributional results of even well-functioning markets may not accord with socially accepted standards of equity. Hence, state intervention in markets is often required to correct adverse distributional effects, and instances of market imperfections—these include problems of immobility of labour, capital and entrepreneurship, absence or inadequacy of information, and high transaction costs[2].

Sixthly, *'Big Push', market and planning* — The market-mechanism is incapable of handling big changes. Rosenstein-Rodan suggests that investment programming (planning) is desirable because of the indivisibility of capital required in development projects and where large rather than small changes are involved. According to him, the price mechanism works perfectly only under the assumption of small changes (Rosenstein-

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[1] As Hirschman (1981:pp.80-81) states about the provision of public goods by the state: "There are many well-known public or semi-public goods of this sort, from power, transportation and irrigation to education and public health often designated as "infrastructure", as though they were *preconditions* for the more *directly productive activities*, these goods have been provided in response to urgent demand emanating from such activities ... [T]hese conditions point to the domain of public goods that must be supplied by the state *if they are to be supplied at all*" (emphasis added by the present author).

[2] As Toye (1993:p.104) argues: "If, despite all the theoretical juggling, distortions in income distribution and the price of labour in developing countries refuse to disappear, and if applied welfare economics provides only an incomplete method of correcting for them in the direction of economic development, what is to be done? Either economic events can be left to take their own course, or governments must have recourse again to familiar techniques of macroeconomic planning to establish the overall framework within which microeconomic choices can be rationally made".

Rodan, 1955:p.513). By their very nature, developmental projects involve big, massive changes which cannot be absorbed through marginal adjustments. Small independent economic agents cannot visualise the need for such changes. Nor do they have the capacity or willingness to undertake the large risks and initial investment involved in these projects[1].

Seventhly, *planning and macroeconomic management* — for some of the arguments put forward by the proponents of 'market-friendly' development policies, for example, the desirability of balanced budgets, free private capital flows to finance development and balanced external current accounts, it is difficult to see how these can be achieved without decisive action to remedy the weaknesses which made state intervention relatively ineffective in the first place. Clearly the debt crisis of the 1980s and its pervasive negative effects on development in highly indebted countries is a good example of market failure.

Since most developing countries suffer from an investment gap, (shortage of domestic savings to cover investment requirements) and a foreign exchange gap (inability of exports to cover imports of goods and services), it is inconceivable to rely on market mechanism to manage these gaps in a manner that would meet the multiple goals of development. What is needed is a long-term macroeconomic planning framework to ensure that growth rate is sustained, inflation is under control, fiscal deficits are sustainable and external debt is manageable. At the same time, governments have to ensure that the economy generates adequate savings to support the investments required to achieve sustainable development and the real exchange rate is in line with the real rate required for internal and external balances. "Governments have a clear responsibility to ensure that growth prospects are not undermined by problems created by macroeconomic

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[1] According to Rosenstein-Rodan (1955:pp.513-515), in the case of big investment projects, the life time of equipment is long (say 10 years) and so "the individual investor's risk may be higher than that confronting an overall investment programme" based on complementarity of industries. Again, "because of the indivisibility (lumpiness) of capital, large rather than small changes are involved"(*ibid.*).

balances[1]" (Weiss, 1995:p.11). Similarly, state intervention is considered necessary to manage all the issues related to balance of payments, foreign aid and external borrowing, regional development, countering the effects of the 'Dutch disease' and creating the necessary mechanism for dealing with windfalls and volatility in the prices of primary produce — as we shall see when discussing the experience of Oman in Chapters IV and V.

Thus in the 1950s and 1960s, for most of the developing economies the only escape route from the low equilibrium trap and vicious circle of poverty was to give a big push to the economy through state intervention by substantially raising the rate of capital formation and allocating the same to various sectors/industries in accordance with a plan. This was to be achieved either through the application of a balanced or an unbalanced growth strategy, adoption of import substituting or outward-oriented industrialisation policies, or sequential combination of all, depending on the specific circumstances of a developing country.

3.5 The Process and Organisation of Planning

It is important, here to examine the concept and definition of planning, the levels and types of planning, the objectives planning is supposed to achieve, questions relating to plan formulation, implementation, and the institutional arrangements needed to assure success in the whole area referred to as planning practice.

3.5.1 Concept and definition of planning

Planning is a complex and multi-dimensional phenomenon, and since it is used in so many different ways, there is often a confusion about its meaning. In the context of defining planning, Waterston (1982:p.27) writes: "Planning has been defined in many

[1] For example, the obvious success of the NICs like South Korea and Taiwan is put down to avoidance by their governments of serious errors in macroeconomic management (*ibid.*:p.9).

ways, but most authorities agree that it is, in essence, an organised, conscious and continued attempt to select the best available alternatives to achieve specific goals. Planning involves the economising of scarce resources".

Conyers and Hills (1984:p.3) adopt the following definition: "a continuous process which involves decisions, or choices, about alternative ways of using available resources, with the aim of achieving particular goals at some time in the near future". "Planning" as Prime Minister Nehru of India succinctly put it, "is the exercise of intelligence to deal with facts and situations as they are and find a way to solve the problems" (Nehru, 1961:pp.33-34). Myrdal points out that basic planning ideology is essentially rationalist in approach and interventionist in conclusions (Myrdal, 1968:p.709). In fact, it is this view of planning as basically interventionist that has evoked such debate among neo-classical economists about the relevance of planning[1].

Thus the main elements comprising the concept of planning are: to plan means to choose; this involves control and allocation of resources, the making of decisions about alternatives and planning for the future.

Since the subject matter of our discussion is planning for development, we will concentrate our review on those aspects of planning which deal with socio-economic development.

By development planning, we mean the deliberate shaping of the process of economic development to achieve a set of inter-related objectives within a given period.

[1] In contrast, a Market is the co-ordinating mechanism where the forces of supply and demand in an economy determine prices, output and methods of production via the automatic adjustment of price movements. At the point of market equilibrium, supply and demand balance and no agent can get a better result than the outcome derived from the equilibrium price. Thus it is quite possible to see the attraction of a theory of pure competition. Under pure and perfect competition there are many sellers and buyers and, if the nature of the commodity is well-defined, the outcome delivered by the market is among the best which can be realised. However, any desired pareto optimum can be reached by the interplay of markets and transfers via subsidies and taxation. The reality is that in sharp contrast to what conventional neo-classical theory teaches. markets do not rule everything. More important is how states adapt to new market pressures.

While Waterston (1982:p.27) defines development planning in the following way: "Countries were considered to be engaged in development planning if their governments were making a conscious and continuing attempt to increase their rate of economic and social progress and to alter those institutional arrangements which were considered to be obstacles to the achievement of this".

And Meier (1987:p.6) provides the justification for planning as: "The case for planning had been founded on a belief in pervasive market failures, the need for a government to step up the rate of development by forcing up the level of investment, and the need to promote external economies and, more generally, balanced growth" (*ibid.*).

Most developing countries in the 1950s, therefore, believed that basic questions relating to how much to save, where to invest, and in what forms to invest could be best handled with the help of a plan.

3.5.2 The levels and types of planning

An important aspect in planning is the relationship between 'policy-making', 'planning' and 'implementation'. Although planning and policy-making cannot be easily separated, policy decisions tend to precede planning decisions in the same way that goals have to be formulated before the policies to attain them can be implemented and planned.

However, policy-making is influenced by the political economy framework within which planning is articulated; that is levels and type of planning will be influenced by a number of political economic factors. These include the broader domain within which the state operates and the reality that, "all societies have 'structures' and states have to obey their logic and adapt to its compulsions" (Kaviraj, 1991:p.73, as cited in Byres, 1994:p.14). Then there is the question of the relative autonomy of the state, because as Byres (1994:p.22) argues, such an autonomy "in principle allows planning as a possible means of hastening capital transformation, in circumstances in which capitalist classes have not yet become dominant" and, as we shall discuss in Chapter V in the case of Oman, the high degree of autonomy enjoyed by the state during the First FYP was crucial in igniting the development process, while the subsequent emergence of vested interests frustrated to a certain extent the objectives of the Second FYP. Of course classes other than capitalist, may hinder or facilitate efficient development. Each situation has to be subjected to a concrete analysis and not posited *a priori*[1].

Therefore, one of the most significant implications of the inter-relationship between planning and policy-making is the fact that planning cannot be considered in isolation from the political ideology of the government in power and the social structure of the society. Factors such as these have direct impact on the role, methods and organisation of planning and on the contents of the plan, with the result that there are inevitably enormous variations from one country to another. For example, the role and nature of planning in a one-party African state such as Tanzania or Zambia, may be very different from the highly populated and unequal society of India, while the situation in India is entirely different from that in Oman.

The same differences apply to levels and types of planning. In terms of types of planning, Waterston (1982:Chapter 2) identifies four broad categories. These are: (i) war-time planning; (ii) town and country planning; (iii) anticyclical planning; and (iv) development planning. Whilst the three most common levels are project planning, sectoral planning and integrated area planning or regional planning. These levels are reflected in the varieties of the plans.

There are many varieties of development plans[2]. Those that are used in socialist countries are 'comprehensive' plans which are prepared in greater detail in order to provide a basis for the mandatory quotas and instructions issued to state agencies for

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[1] For example, the present Sultan's father was clearly antagonistic to change; he was the ruler of a Sultanate; the present Sultan is the ruler of the Sultanate of Oman — but he is very favourably disposed to change and towards planning to secure this as efficiently and profoundly as possible.
[2] See Waterston (1982:Chapter 5) for a detailed survey of varieties of development plans.

implementation. These plans are typically divided into sectoral and regional plans which have to be integrated in the national plan.

Comprehensive plans in mixed economies, generally, rely on broad aggregate targets which are conceived as indicators rather than binding targets. The degree to which comprehensive development plans of countries with mixed economies are divided into detailed sectoral and regional programmes varies greatly among countries and among sectors in a country. These may also vary in the same country over time, depending on the stage of development[1]. Generally, the sectors of the plan in which public investment predominates are worked out in greater detail than those in which private investment prevails.

As a rule, plans in mixed economies such as Oman are binding on the public sector where government has direct control, but not on the private sector where persuasion in the form of incentives is mainly relied upon to influence the size and composition of private investment within a plan[2]. Public investment programmes although covering only a part of an economy, are generally considered to be the development plans. As Waterston (1982:p.110) states "most national development plans are public investment plans".

Similarly, Yukawa (1988:pp.21-22) indicates, many countries with mixed economies adopt the project-by-project approach to planning at the beginning of their development. However, such an approach can lead to great difficulties in co-ordination, as Oman's experience[3] discussed in Chapter V shows. Therefore, it may be desirable to replace this approach with integrated public investment planning, combining individual

[1] The evolution of development planning, in Oman, as we shall see in Chapter V, through the successive five-year plans, in its scope and coverage, resembles this typology.
[2] The French plans have been called mandatory in the public sector and "indicative" in the private sector (Waterston, 1982:p.117).
[3] Oman adopted the project-by-project approach between 1970 and 1975, at the start of its development process. However, the failure of co-ordination between these projects on one hand and between the implementing ministries and the treasury on the other, led to a severe financial crisis in 1974. This led to adoption of formal planning in Oman (Oman, 1976a).

projects into sectoral programmes and then into an investment plan for the public sector, as has been the case in Oman's successive five-year plans. As a country moves into a more advanced stage of development, comprehensive planning — the most complete form of development planning — becomes feasible. Development plans differ as much in duration as in form, but they may generally be classified as short-term, medium-term, or long-term. Short-term plans are typically for one year, while medium-term plans are for periods ranging between three and seven years, with five years as the most common case, and long-term plans for periods of ten to twenty years (*ibid.*).

Lewis (1951), Tinbergen (1967) and Yukawa (1988) suggest that planning should start with a perspective plan, incorporating the country's long-term perspectives and development objectives. "Perspective plans are recommended because they can promote fundamental transformations in the social and economic structures which economic development requires by its very nature and which a shorter-term plan would not be able to bring about" (Yukawa, *op. cit.*:pp.21-22).

3.5.3 Plan formulation and implementation

The concept of planning as a means of achieving goals raises issues about the nature of the goals and the process of goal formulation. This, in turn, raises another complex set of issues about who should be responsible for the formulation of goals and whose interests should be represented when formulating these goals. Moreover, since planning involves allocation of resources, the question of identification, mobilisation and deciding on alternative courses of action becomes equally crucial.

Byres (1994) describes the manner in which *plan formulation and planning techniques* have evolved in India since 1947; for example, the use made of successive planning models to underpin economic strategy, the early progression to perspective planning, and the manner of its development, and the procedures by which targets have been set.

An important aspect of the planning process[1] is selecting and co-ordinating the best available alternatives in order to give desirable direction and to accelerate a country's development. Therefore central to the process of plan formulation is the question of the policies formulated to tackle particular issues facing a country at a certain time.

Again as mentioned before, the type of policies and strategies a country adopts depends on its initial conditions, resource endowment and political context. Therefore, between 1950 and 1970, many LDCs adopted planning as an escape route from the low level equilibrium trap by substantially raising the rate of capital formation and allocating the same to various sectors and industries. As Tani (1988) in his analysis of the arguments and benefits of economic planning in Japan states:

> It was the economic plans of the second post-war decade that established effective procedures for comprehensive indicative economic planning which *mobilised* the nation to build an independent national economy through rapid industrial transformation ... [T]he second economic plan noted market forces *hindered voluntary adjustment* among private enterprises and argued that these limits necessitated indirect government *intervention* in the market ... [T]he market mechanism is not perfect, but has defects identified by recent developments in economic theory with policy implications for sectoral policy frameworks (Tani, 1988:pp.280 and 293).

[1] Benhakker (1980, cited in Conyers and Hills, 1984:p.72) identifies 10 stages. These are: (i) appraisal of the current state of affairs: (ii) assessment of future directions for progress and preliminary priorities among direction; (iii) preliminary formulation of objectives and estimation of available funds; (iv) consideration of alternative courses of action; (v) specification of objectives and sub-objectives; (vi) identification of alternative programmes, projects, policies and strategies; (vii) search for the best solutions; (viii) derivation of evaluation criteria; (ix) application of evaluation criteria; and (x) determination of action plan and budget.

The works of a number of authorities on economic planning [Lewis, (1951 and 1966); Grossman, (1974); Waterston, (1982); Chakravarty, (1987 and 1991); and Urrutia and Yukawa, (1988)] identify the following items which they suggest are the essential requirements of a development plan:

i) Planning requires first the creation of a public authority which is empowered by the government to prepare the plan and review its implementation and achievements. In most developing mixed economies, the plan is implemented by the executive branch of the government i.e. by the ministries and departments of the government. These may operationalise the plan through public and private sector organisations. In the case of Oman, the Development Council was set up in 1975 to provide strategic guidance and political impetus to the plan, while a technical secretariat was established at the same time to prepare the plan and provide technical support to the Council and to the implementing ministries.

ii) A survey and diagnosis of the existing economic situation and stock of available resources must be included in a plan.

iii) A plan must clearly set out the objectives or the goals of development to be achieved by the plan. Since the objectives may be in conflict or be mutually exclusive, they have to be prioritised in relation to investment allocation. These objectives have to be translated into quantitative targets.

iv) A plan must be based on a development strategy or a set of strategies to achieve the plan goals. The strategy identifies the means-ends (cause-effect) relationships as well as the political blockages to development. It also involves a strategy for resource mobilisation. The strategy indicates the economic theory on which the plan model is based. In mathematical language, the strategy or the model is shown by a set of equations. The strategy must be internally consistent and reconcile conflicting objectives.

v) A plan must provide macroeconomic projection for the whole economy showing projections for future growth rates of population, national income, employment, savings, investment, exports, imports, private sector outlays, broad sectoral output growth, etc.

vi) A plan is incomplete if it does not state the policy instruments to be instituted to implement the different components of the development strategy. The plan strategy can be achieved through two types of policy instruments viz. (a) administrative directions and controls i.e. planning by direction; and (b) invisible controls of price mechanism i.e. planning by inducement (Lewis, 1951:pp.14-26).

vii) Since a plan implies time-bound actions, it should provide a time schedule and sequencing of implementation of policies and achievement of targets. The sequencing of implementation should be incorporated in the plan strategy or model.

In the case of Oman, as we shall see in Chapters IV and V, a ten point long-term development strategy has guided the planning process since 1975 and the five-year plans' documents have identified short — and medium-term objectives that need to be achieved within the framework of this long-term strategy. A package of policies, measures and projects to achieve the established goals is also laid down in each plan.

Associated with the formulation of the plan is its implementation. Until recently, as Waterston (1982:pp.333-336) indicates, it was thought that the key element in the planning process was the formulation of an economically consistent plan. It was not generally realised that a consistent plan does not ensure implementation any more than an inconsistent one. Thus failure to implement the policies and required actions contained in plans, programmes or projects is widely recognised to be one of the main if not the only, weakness of contemporary planning in Third World countries (Waterston, 1982). Pressman and Wildavsky (1973) define implementation as a process of interaction between the setting of goals and actions geared to achieving them; while Grindle (1980) suggests that the task of implementation is to establish a link that allows the goals of public policies to be realised as outcomes of government activity.

In the same vein, Chakravarty (1987) concludes that the dichotomy which is seen to exist between theory and planning in practice in India can be viewed in terms of the neglect of the 'feasibility of plans'. He suggests that "a good plan must minimally attempt a proper appraisal of the feasibility of what it normatively postulates" (*ibid.*:p.132). A second interpretation of this dichotomy would be in terms of the level of aggregation involved in macro-economic planning and its inability to influence the very large number of actors involved in implementation of plans, i.e. the failure to capture the true state of underlying structural relationships.

There are a number of other factors that affect plan implementation such as the nature of the planning process and the contents of the plans. The two most important ones are — organisation of planning and implementation, and management of the implementation process. The importance of the first factor lies in the fact that many of the problems of plan implementation can be attributed to organisational factors, including inadequate co-ordination between professional planners and others involved directly or indirectly in the planning process and the lack of co-ordination between these and other individuals or organisations, especially the various components of the government's administrative machinery (Waterston, 1982:Chapters 8 and 9).

An important aspect of the management of the planning process is the mobilisation of resources — finance, manpower and equipment — needed to undertake actions embodied in plans. Many plans are not implemented as planned because these resources are not available in the right quantity, at the right place, and at the right time (Conyers and Hills, 1984). Another important part of the management process is monitoring and evaluation. A variety of techniques have been developed to assist the planners to improve the management process such as critical path analysis, bar charts, programme evaluation and review technique[1].

[1] Conyers and Hills (1984:pp.154-175) give full details of these techniques

In addition to the internal factors that impinge negatively upon plan implementation, there are external factors that can also have either a negative or positive influence on the outcome. These include, *inter alia*, the international political environment, fluctuations in terms of trade, international boom or recession, which as we shall see in Chapter V, have influenced both the formulation and implementation of successive five-year plans in Oman.

3.5.4 Institutional arrangements in planning

Effective planning means not only having 'good' plans but also an appropriate and efficient organisation[1] for implementation and evaluation. "The successful implementation of a plan is largely a matter of proper organisation and administration" (Waterston, 1982:p.339). Similarly, Waterston emphasises the need for plans to be realistic in terms of the resources available for plan implementation and the political and administrative capacity required to support and implement them. "A good plan" he says, "is realistic and a realistic plan does not set unsustainable targets" (*ibid.*:p.344). Thus Waterston finds that:

> The available evidence makes it clear that in countries with development plans, lack of adequate government support is the prime reason why most are never carried out. Conversely, the cardinal lesson that emerges from the planning experience of developing countries is that the

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[1] Waterston (1982) provides in Part Two of his study a full review of the Organisation of Planning. However, the kind of planning machinery a country adopts, depends largely on its political, social and economic institutions and its stage of development. Establishment of a central planning agency is seen as normal in most developing countries as development proceeds. In many mixed economies, the budget office located in the ministry of finance acts as a *de facto* planning authority. A central planning agency is normally responsible for (i) the formulation and revision of national development plans; (ii) the preparation of annual plans; (iii) recommending policies and measures required to implement plans; (iv) monitoring and evaluating implementation; and (v) co-ordinating foreign technical assistance. Some countries have added the central statistical office as a part of the planning agency as is the case in Oman, where the statistical office is part of the Ministry of Development. Experts differ on the appropriate location of a planning agency, but in a country where planning is accorded high priority, such an agency is almost invariably located close to the chief executive; again, this has been the case in Oman.

> sustained commitment of a politically stable government is *sine qua non* for development. Where a country's leadership makes development a central concern, the people can also be interested through the judicious use of economic incentives (*ibid.*: p.367).

Streeten (1995:pp.236-238) explains that institutions determine the organisational basis from which the energy, commitment and enthusiasm of the beneficiaries can be enlisted. He thus finds that too much centralised decision-making may fail altogether, or if successful, will prove extremely expensive; too much reliance on "bottom-up" initiatives will be frittered away or be taken over by local power elites[1].

In the same vein, an evaluation of the Indian Planning System (Byres, 1994:p.532) found that the problem of planning in India was not one of technical capabilities and functionaries but had to do with the nature and levels of a decision-making process which was too bureaucratic and centralised.

3.6 Planning in Practice

We shall now examine the way planning has worked in practice and the manner in which the institutional factors have influenced the outcome. This will be done by first, reviewing the experience of China and India followed by the case of Japan and South Korea. We shall then examine how planning and market in Oman have worked together in practice.

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[1] The way economic and social processes evolve has been a source of some debate. Polanyi (1957) argues in *The Great Transformation* that conscious political action is required to transform market activities into a market economy. "The step which makes ... regulated markets into a self-regulating market, is indeed crucial. The nineteenth century ... naively imagined that such a development was the natural outcome ... It was not realised that the gearing of markets into self-regulating system ... was the effect of high artificial stimulants administered to the body social" (Polanyi, 1957:p.57 as quoted in Palan, *et al.*, 1996:pp.28-30).

3.6.1 The case of China and India

China and India provide a good basis for comparing the experience of planning. Both countries are large and had strong structural similarities at independence for India (1947) and China at Liberation (1949). Both adopted planning as a major means of accelerating the process of socio-economic development (Conyers and Hills, 1984:pp.41-61).

The economic structures of India and China at that time, as Byres and Nolan (1976) state, were weakly developed. In both countries, technology was backward with a negligible amount of per capita agricultural output and only a minor part of industrial output was produced with modern techniques, hence per capita output was low. The economy was dominated by agriculture which generated the major part of national income and employed an overwhelming majority of the working population.

In 1950-51, agriculture contributed 50 per cent of total national income in India and employed 70 per cent of the working population. In China in 1952, agriculture contributed an estimated 47 per cent of national product and employed between 75 and 83 per cent of the population (*ibid.*:p.11).

However, an important difference that existed between the two systems was the nature of the state and the respective 'modes of production' and the quality and effectiveness of planning that was possible. On the one hand, an effective planned economy in China operated through near state monopoly of internal and external trade, predominantly state-owned industry and collectively run agriculture; these were brought into being by the political revolution of 1949, which swept away the class interests of a semi-feudal society, pre-empted the possibility of capitalist development and made possible a socialist path for China (*ibid.*).

On the other hand, planning in India has been essentially ineffective (excellent at the level of formulation, very weak at the level of implementation, as we noted in section 3.5.3) and there has not been that firm rooting and growth of capitalism that planning has sought to achieve. In terms of autonomy of the state, Byres (1994:p.22) argues that in India, in the aftermath of independence, a capitalist class or capitalist classes, were weakly developed and could not effect the transformation of the economy in both town and country and society without state support.

In both countries there was a commitment to economic and social progress — in terms of development and reduction in inequality. In terms of strategies chosen, there was a recognition in India that a doctrine of *laissez-faire* must be replaced by a commitment to economic planning in order to promote (capitalist) development and furthermore, in certain sectors, public enterprises would suitably complement the development of private enterprise.

In terms of economic performance although China's overall pattern of economic growth has been uneven,[1] its overall rate of growth has been higher than India's. China's gross national product grew at a compound annual rate of growth of 5.6 per cent between 1952 and 1970, while in India net national product grew by about 3.7 per cent between 1950 and 1970; the equivalent annual per capita growth rates were 3.4 to 4 per cent and 1.5 per cent respectively. Industrial production in China grew by a compound annual rate of 11.9 per cent, while in India it grew by 6.5 per cent during the same period. Agricultural production during this period grew at a compound annual rate of 2.5 per cent in China, while in India the growth rate was 2.3 per cent (Byres and Nolan, 1976:p.51).

In terms of inequality, again Byres and Nolan's (1976) study finds that China has had a higher degree of success in reducing inequality. This they ascribe to the transformation in economic structure that followed the liberation, with the establishment

[1] This was because of the economic collapse from 1959 to 1963 after the Great Leap Forward, and by the less severe decline in output in 1967 and 1968 during the Cultural Revolution (Eckstein, 1973, as cited in Byres and Nolan, 1976:p.51).

of predominantly state owned industries and collective ownership in agriculture. In India, despite the policy statements included in successive plans, the net effect has been rather inegalitarian. This is ascribed to the hierarchical class structure in the Indian political economy.

Again, the recent experience of these two countries, in the wake of market-reforms and liberalisation undertaken by them, is quite different. In the case of China, which began to liberalise its markets and privatise its economy in the late 1970s, the expansion of rural agriculture and industrial output had a significant effect on income poverty[1]. The incidence of poverty in 1978-85 fell from 33 per cent to 9 per cent and the number of rural poor fell from 260 million to 97 million (UNDP, 1997:p.49).

However, with a shift in development strategy, after the mid 1980s, towards industrial and export sectors, and a redirection of public investment and fiscal incentives to the coastal regions, the progress in human development went into reverse. By 1989 the number of income — poor people in rural areas increased to 103 million, adult illiteracy increased between 1982-87 from 24 per cent to 27 per cent and disparities widened (*ibid.*).

Being concerned about the increase in poverty and widening regional disparities, the government in China started in the early 1990s to take measures to reverse the trend. A Poverty Reduction Programme, which aims to eradicate absolute poverty by the year 2000, was also launched in 1994. By 1992, this renewed commitment by the state was already showing results. Between 1991 and mid-1995 the number of people living in income poverty fell from 94 to 65 million (*ibid.*:p.50).

In the case of India, during the period following economic reform in 1991, although there was firstly a rise, then a fall in income poverty, but by 1993-94, the

[1] A person is poor if, and only if, his/her income level is below the defined poverty line. Often the cut-off poverty line is defined in terms of having enough income for a specified amount of food (UNDP, 1997:p.16).

incidence of income poverty in rural areas had increased to 39 per cent, compared to 34 per cent in 1989-90. To address this question, the Ninth FYP (1997-2002) calls for eradicating poverty by the year 2005. However, as the 1997 *Human Development Report* states, a cause for concern is the emphasis given in India, to deficit reduction and state minimalism, which is leading to the abdication of state responsibilities in key areas affecting the lives of poor people. "India needs sustained public action if it is to eliminate the worst forms of poverty and promote an equitable expansion of social, economic and political opportunities" *(ibid.*:p.52).

Thus as table 3.2 below indicates, China with its emphasis on integrating the market within the planning system, with the state taking a direct role in ensuring a more equitable distribution of social services, has continued to out-perform India. In 1994 for example, illiteracy in China was 19 per cent and income poverty incidence was 7 per cent whereas, in India the percentage was 48 per cent for the former and 39 per cent for the latter.

Table 3.2

Comparison of main socio-economic indicators : China and India 1970-1994

Indicators	**China**		**India**	
	1970	**1994**	**1970**	**1994**
Adult illiteracy (%)	34	19	66	48
Under-5 mortality rate (per 1000 live births)	209[a]	47	236[a]	115
Real GDP per capita (PPP$)	723[a]	2,604	617[a]	1,348
Income poverty incidence (%)	33[b]	7	54[c]	39
Human development index	0.248[a]	0.626	0.206[a]	0.446
External debt as % of GNP (1994)	-	19	-	34

Notes:

a) Data for 1960; b) Data for 1978; c) Data for 1974.

Source: UNDP (1997) *Human Development Report 1997*, pp.49-52.

3.6.2 The case of Japan and South Korea

Japan's economic growth in the post-war period is generally cited by development textbooks as a shining example of what an outward-oriented and market-based economy can achieve. Few Western economists generally highlight the fact that economic planning has played a vital role in the structural transformation of the Japanese economy (Wade, 1990:pp.22-24)[1].

With the end of Korean war[2], the second decade (1955-64) of post-war recovery in Japan began with acute foreign exchange shortage and vast unemployment. To deal with these problems the First FYP prepared by the Economic Council was launched with two basic policy objectives: economic self-reliance (through external balance equilibrium) and removal of unemployment (Tani, 1988:p.263-310). The plan provided two sets of policies viz. comprehensive macro-economic policies and sectoral industry — specific policies.

Industrial revival necessitated large scale imports of capital goods and technology. But foreign exchange supply was limited because in the absence of competitiveness, exports could not grow. The self-reliance plan i.e. the First Plan (1956-60) provided intensive policy guidelines for industries to confine use of scarce foreign exchange to enhance productivity. Close consultations between administration and private business dispensed with the need for direct controls and enabled the Ministry of International Trade and Industry (MITI) to provide clear strategic directions for overcoming supply-demand gaps.

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[1] Wade (1990) cites names of several economists whose works emphasise the role of markets and private enterprise and underplay the "supportive" role of the state and planning.

[2] Japan was used as the main supplier of non-military requirements for the Korean war. "When the Korean war broke out and relieved Japanese industry from deepening depression, the government resumed the advancement of industrial policy ... [i]n response to the economic upswing triggered by the Korean war" (Tani, 1988:p.297).

The first two plans and the Third Nine Year National Income Doubling plan (1961-70) established procedures for indicative planning to achieve macroeconomic as well as sectoral objectives and targets. The planners stressed the compatibility of planning with a market economy. The defects of the market system were identified as economic disorder (fluctuations), inflation, balance of payments problems and general unemployment. These problems needed to be solved through achievement of collective targets indicated in the plan (*ibid.*).

The publicity of plan targets served the purpose of gaining peoples' co-operation in the development process. They communicated to the private business the methods and objectives of comprehensive and sectoral policies so that they could extend voluntary co-operation to achieve these targets (*ibid.*).

Since the private sector was involved in the formulation as well as implementation of plan and policies, its co-operation in achievement of objectives and targets was assured. Hence the plan was implemented through the operation of the market mechanism.

In contrast to the spontaneous, uncoordinated free market economy of the neo-classical theory, the economy of Japan is a 'planned' economy which operates through the market mechanism to achieve pre-determined objectives (targets) and which uses market-related instruments to implement a preconceived development strategy with an elaborate scheme of inter-sectoral priorities. Between 1955 and 1990, the Japanese government has adopted ten economic plans, each of which had a time frame of five to ten years with revisions made every three years on an average (*ibid.*:pp.280-281).

In fact, as Tani (1988) finds in his analysis, economic planning in Japan has been used to devise macro-economic policy guidelines which have been successfully used to integrate individual sectoral policies. And as economic planning succeeded in transforming the economy to self reliance in the final stage "[t]he economic policy was oriented towards liberalisation of a market which had been isolated from international competition, thus preparing the way for a fully open market economy" (*ibid.*:p.309).

A close examination of South Korean development strategy suggests that Korean economic development was anything but market-led. As Dutt and Kim (1994:p.186) point out "the selective promotion of infant industries and the upgrading of the country's competitive advantage by articulate industrial policies, all this through the concerted efforts for resource mobilisation, were the key elements of state activism in Korea[1]".

It was during Park's regime (1961-79) that planning achieved ascendancy. The state established its supremacy and autonomy in matters of economic policy.

The government selected 'strategic' industries for support under a series of five-year plans. In the initial plans, labour intensive industries were selected. But as development took place, the later plans selected heavy and capital extensive industries (for example steel, chemicals, ship building, etc.) for strategic targeting. Long-term finance and credit were deliberately channelled to industries which could access globally competitive technology. Korea's outward-oriented trade policy emphasised exports but this was combined with protection to selected domestic industries, particularly in capital and intermediate goods sector so that the selected private as well as state enterprises could achieve scale economies combining the most modern technology.

According to Dutt and Kim (1994:p.176) "in the case of Korea, import substitution and export promotion proceeded together, possibly with some time lag. Its expression in outward orientation must not be interpreted as an example of trade liberalisation in the neo-classical sense".

Underlying Korea's structural transformation and outward-oriented rapid economic expansion was the decisive economic planning which directed the market forces

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[1] In this study Korea and South Korea are used interchangeably.

to move in pre-determined strategic directions and achieve state determined objectives and targets. The variety of incentives that the state provided for industries and firms involved in export promotion included: tariff exemptions on imports of raw materials and spare parts, tariff and tax exemptions granted to domestic suppliers of exporting firms, indirect tax exemptions, lower direct taxes on income earned in exporting, accelerated depreciation allowances, import entitlement linked to exports, reduced public utility rates, monopoly rights granted in new export markets, credit subsidies through lower interest rates, and automatic access to bank loans for working capital.

Consequently, both Japan and South Korea have combined planning with market to achieve rapid economic development. And these two economies could successfully and effectively synergise plan and market mainly because the state was pragmatic and had a purposeful, decisive, competent, and single-minded administration which was clear in its vision, objectives and priorities. The state co-ordinated the activities of the administration and private business, and it secured the acquiescence and co-operation of society to implement its planned strategy of development. Of course, resources in the form of aid (loans and grants) to Korea from the USA greatly facilitated the operation of the state in this context (Nazir, 1991:pp.28-31). But having resources in itself does not guarantee the use (good or bad) to which these are put. Thus appropriate policies and planning are crucial, in addition to having access to resources in securing economic and social development.

3.6.3 Planning and market in Oman

Among the developing economies, Oman provides a notable example of the state combining the market and planning strategies to secure long-term development objectives with minimal generation of conflict. The attainment of these objectives and the means by which they were secured are discussed in Chapters IV, V and VI. Here only a brief summary of the roles of planning and market in Oman's development is necessary.

As in other oil exporting countries, economic rents earned from production and export of oil constitute a substantial share of national income in Oman, and this is realised through the state. The resources generated by oil exports are used by the state for the development of the economy through development planning. The benefits flowing from national assets created by the plans (electricity, water, industrial infrastructure, gas, petroleum products, etc.) are distributed through the functioning of the price system. The use of these basic inputs and access to state sponsored financial institutions encourage growth of private enterprises in agriculture, industry, and a relatively large service sector.

The revenues derived from the export of oil have enabled the government in Oman to maintain an open economy, with imported consumer goods, capital equipment and technology flowing into the economy without any significant tariff barriers. Quota restrictions are almost non-existent. The exchange rate of the Omani Rial is pegged to the US dollar and the Rial is freely convertible, without any foreign exchange restrictions. Exports are encouraged while imports are not discriminated against. As a result, high consumer welfare has been achieved so far without the creation of any substantial industrial sector. In other words, the welfare-oriented approach of the state complements both plan and market to secure social and economic development.

From the mid 1970s, Oman has adopted development planning which is implemented through successive five-year plans. The methodology of planning in Oman is briefly explained in Appendix 3-AI. The main long-term strategic goals underlying these five-year development plans are (Oman, 1976a):

a) to bring about sustained improvement in the quality of life,
b) to reduce dependence upon oil exports by diversifying the economic base through accelerated growth of the non-oil sector,
c) to develop human resources,
d) to promote balanced regional development,
e) to sustain a free market and competitive economy,

f) to follow a free trade policy, with minimal restrictions on inflow and outflow of goods, services, capital and technology.

The purpose of development planning in Oman is not to supplant but to supplement and stimulate the market. Attainment of plan objectives in Oman does not involve any physical or price controls or any fiscal "carrots and sticks" for private sector activities. Nor does it involve any strict demarcation of areas of activities for the public and private sector. Apart from some restrictions on the inflows of foreign capital and labour, the economy of Oman is almost completely open to the rest of the world so far as the flow of goods and non-factor services are concerned.

The essential role of development planning in Oman is to promote investment in sectors providing public goods, to formulate and execute projects involving large scale externalities, and to build up social overheads entailing low rates of return. Since the private sector would be disinclined to undertake these activities, the growth of public investment through development plans did not result in 'crowding out' private investment in the relevant activities. In fact, the income-generation and threshold-creating effects of public investment has led to 'crowding in' of private investment as we shall see in the following three chapters. It is in this sense that planning in Oman has supplemented and not supplanted the market mechanism and the private sector.

In addition to socio-economic development, planning in Oman has also facilitated regional development. Within the framework of the long-term development strategy a general policy for town planning was approved by the Cabinet[1] in 1988. The main elements of town planning policy include: specification of standard physical planning criteria and policies; harmonisation of policies and measures relating to land use; provision of social structures and public utilities on a national, regional and local level; and planning and programming of available resources. The policy intends to provide consistent physical and regional development plans and realise the long-term development

[1] The Council of Ministers.

objectives, including protecting the environment and preserving natural resources (Oman, 1991a:pp.223-251).

To facilitate implementation of town planning policy a "Main Town Strategy" has been adopted. The strategy aims to direct investments to a number of main towns to increase the effectiveness and efficiency of these investments through economies of scale and also to create on the one hand, backward and forward linkages between the main towns and on the other, between the regions and the local centres and the main towns.

As a result, both the Third and the Fourth FYP allocated large amounts for development of a number of main towns, such as Nizwa, Sur, Al-Rustaq and Sohar (*ibid.*:pp.359-363).

To monitor implementation and provide overall guidance, the Supreme Committee for Town Planning was set up in 1985 (Oman, 1995c:p.99) and a number of regional committees, such as the Musandam Development Committee and the Regional Development Council were established by the Development Council.

3.7 Market-led Development Strategies

The three areas where neo-classical economists would consider state intervention justifiable are: (a) in cases of market failure; (b) when there is desire to change income distribution; and (c) when an infant industry needs short run protection till it can compete in the open market.

The proponents of development through the market-mechanism believe that with the exception of only the above mentioned cases, the state should confine its role to protection of property rights, enforcement of contracts and anti-monopoly laws. The post-Second War literature on the neo-classical political economy provides theoretical reasons for the argument that state intervention in the free play of market forces would result in wastage of scarce productive resources. State intervention from a neo-classical perspective is analysed in the context of market failure and the operation of interest group politics.

These theoretical analyses with significant contributions by Olson (1965), Krueger (1974), Buchanan (1980), Bhagwati (1982) and Srinivasan (1985) apply standard neo-classical rules of individual optimisation to voters, politicians, lobbies and interest groups involved in the making of social or collective choices and decisions through the instrumentality of governmental mechanism. Accordingly, voters are utility maximisers voting for politicians and parties who will satisfy their own individual (sectional) interests regardless of the interests of the whole society. Politicians who influence government and civil servants are vote maximisers interested only in acquiring or holding on to power. They will provide policies or social choices that will bring maximum votes regardless of their effects on overall development. Lobbies and interest groups would bribe or pressurise politicians to influence government decisions on social choices with a view to fulfil their narrow sectional interests. The result is an inefficient and inequitable allocation of resources, general impoverishment and reduced freedom.

Therefore, when the government interferes with free play of market forces and price mechanism through actions such as import quotas, restrictions on investment in particular (licensed) industries, rationing and allocation of consumer goods or raw materials, price controls etc., it creates 'rents' of various forms[1] or 'unearned' profits. According to Krueger, Bhagwati and Srinivasan, state intervention induces rent seeking activities using real productive resources in setting up lobbies, election campaigns, influencing political parties, etc. Such use of resources earns profit and hence it is rational from the viewpoint of private individuals but it does not result in increased output of any good or service and hence such activity is socially undesirable. Such activity is therefore described as directly unproductive profit seeking activity. This DUP results in loss of

[1] Rent in economics means any payment to a factor which is in excess of what is necessary to engage it in its present employment i.e. payment in excess of its transfer or next best alternative earnings. Rent is thus a surplus arising on account of relative scarcity (Meier, 1989:pp.535-536).

welfare in the sense that resources used in rent-seeking activity could have been used alternatively to produce some goods or services. The theories of 'rent-seeking', therefore, argue that various types of state interventions in the free play of market forces work against development by leading to 'unproductive' use of scarce productive resources.

These theories of optimising politicians, public choice, rent-seeking and DUP are used to provide theoretical support in favour of leaving the market mechanism free from state intervention for promoting development in the LDCs.

3.7.1 Rethinking the state

As we noted in Chapter I, from 1980 onwards the neo-classical views on economic policy[1] and market reforms have dominated the development debate. The SAPs undertaken by a number of developing countries under the auspices of the IMF and the World Bank have become the main conduit for promoting the neo-liberal[2] development models. As a result, governments have adopted policies to reduce the scope of state's intervention in the economy. Market-friendly strategies — as propagated by the World Bank (World Bank, 1991a) — have taken hold in most parts of the developing world.

The 1997 *World Development Report* (World Bank, 1997a) is, therefore, an important point of departure for the World Bank concerning the appropriate role of the

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[1] Both Chapters I and II provide details of the policy prescription of the World Bank and the IMF and their 'market-friendly' approach to economic development.

[2] The term neo-liberal refers to those economists who have revived liberalism in its new form. Both in theory and practice liberalism has, over the last two centuries, advocated the central idea of individual liberty under the rule of law. People must be allowed to pursue their own interests so long as they observe the rules of not encroaching upon liberty of others. In economics, liberalism was closely associated with market capitalism based on free competition and free trade. However, under the Keynesian influence, in the post-world War II era, the character of market capitalism changed significantly, with the state assuming responsibility to ensure full employment and social welfare. Leading the attack against this state regulation of market capitalism, the neo-liberal economists like Milton Friedman and James Buchanan revived liberalism in its new form by providing theoretical arguments to show that government intervention — except in provision of public goods — is generally contrary to public interest and, through rent seeking activity, it leads to unproductive use of scarce resources (See Eatwell, *et. al.*, 1991:pp.173-175). The terms neo-liberals and neo-classicals are used interchangeably in this thesis. Although the former has broader political-economy connotations.

state in development[1]. The report confirms the evidence that the success of today's industrialised world and the post-war "miracles" of East Asia is not due to a minimalist approach to the state. Instead, it argues that these examples have shown that development requires an effective state, one that plays a facilitating, encouraging and complementing role to the activities of private business and individuals.

"[C]ertainly, state-dominated development has failed. But so has state-less development — a message that comes through all too clearly in the agonies of people in collapsed states such as Liberia and Somalia ... Without an effective state, sustainable development, both economic and social, is impossible" (World Bank, 1997a:p.III) .

Our analysis in this chapter of country specific development confirms the revised views of the World Bank which contradict the neo-classical approach to development management and its call for 'rolling back' the state.

3.8 Conclusion

This chapter has provided a theoretical and empirical analyses of planning and the market in development. The role of the state in using the plan and market in securing development have been shown to be intertwined and mutually reinforcing. The effectiveness of planning in securing development has been demonstrated in relation to particular countries, e.g. the impact of planning on achieving higher standards of living in Sri Lanka.

We have shown that the path of development a country adopts depends on a number of factors which include its initial conditions and its resource endowment. And that the outcome of development planning is similarly influenced by a number of historical

[1] The Report states that "the state's potential to leverage, promote, and mediate change in pursuit of collective ends is unmatched. Where this capacity has been used well, economies have flourished. But where it has not, development has hit a brick wall" (*ibid.*:p.157).

factors the political economy of the country, external factors and the context of international political economy in which it embarks on its development process.

We have shown that there are compelling reasons for developing countries to adopt development planning in dealing with problems of capital scarcity, poverty, unemployment, income distribution, market failures and unfavourable terms of trade. However, we have shown that planning and market need not be seen in mutually exclusive or static terms. They can be complementary and their relationship may change over time depending on circumstances.

An important factor which influences the path of development selected and the possible outcome is the nature of the state in each country and the quality and effectiveness of planning. In the case of China, planning has enabled it to establish a high degree of self-reliance which has in turn given it freedom of manoeuvre in relation to domestic political, social and economic policies. Planning also has enabled it to achieve a qualitatively better development than India, where planning and the market have been utilised.

Similarly, in the case of Japan and South Korea, the strong commitment of the state and favourable external factors, enabled a combination of planning and the market mechanism to secure very high levels of development.

In Oman too the combination of plan and market has been crucial in securing socio-economic development through two decades of development planning.

In a world divided by large disparities within countries and between countries, where comparative advantages are being gradually eroded, and new competitive advantages are created, the case for 'rolling back' the state is indeed very weak. On the contrary, a strong and effective state is required to negotiate the obstacles which impede the development process in the developing countries. In fact, development is a dynamic process, and it invariably is a process in which planning and direction on the one hand, and freedom of private enterprise on the other play mutually reinforcing roles, *albeit* with the level and intensity of the one or the other changing with each stage of development.

Appendix 3-AI

Planning Methodology in Oman

In the First and Second FYPs (1976-80 and 1981-85), the basic methodology of planning was that of investment programming of projects. The planning machinery prepared a balance of financial resources by estimating expected annual revenues and expenditures under broad headings. This provided the aggregate funds for public investment. Within these broad parameters, the development projects prepared by different government departments were approved and resources were allocated according to their priorities, derived from the basic development goals. By using the development projects as the basic units of economic planning, the government was quite effective in implementing a number of projects relating to economic infrastructure, education and training, and health.

The First Plan was quite successful in creating a wide ranging network of economic and social infrastructure. This not only established a strong foundation for non-oil sector's growth and enhanced the absorptive capacity of the national economy but also led to an increase in private sector's capacity and the growth of the market (Oman, 1981a:p.31). The Second Plan not only continued with this project-based investment allocation but also focused on creating the necessary mechanism for dealing with the oil price volatility and mitigating the impact of the 'Dutch disease'. This was achieved by creating the State General Reserve Fund. Contributions to the SGRF were to be made out of gross oil revenues and the SGRF serves the purpose of a 'buffer' to be used for budget deficits in years of low oil prices, or receiving oil windfalls in periods of high oil prices (Oman, 1981a:pp.38-39). The method of formulating the Third FYP was similar to that of the Second FYP. However, the Third FYP was focused on stabilising the economy in the wake of the 1986 oil price collapse and hence it was more oriented towards achieving fiscal balance.

Appendix 3-AI contd...

During the First, Second and Third FYPs, project programming was not derived from sectoral and regional targets for investment and production. Actually, the regional and sectoral investment patterns emerged as the outcomes of projects-based planning (Oman, 1991a:pp.34-35).

The Fourth FYP (1991-95)

The technical expertise in planning and management built up over the previous three plans at both the level of technical secretariat and the various units of the government made possible important changes in the planning methodology for the Fourth FYP. This was further helped with the progressive improvement in the availability of statistical information. The Development Council in 1989 (after a series of preliminary steps in preparing the plan and after a series of meetings) approved the report prepared by the technical secretariat "The Improvement of the Comprehensive Planning Techniques and Objectives Proposed for the Next Phase (1991-2000)" (Oman, 1991a:p.27).

This report, which was based on a comprehensive analysis of the experience of the previous three plans, contained recommendations to improve planning processes, monitoring techniques and data collection and analysis systems. Special emphasis was to be given to sectoral and regional dimensions of development in the planning process, in addition to expanding the participation of different actors, namely, Majlis Ash'Shura, the private sector, Central Bank of Oman, executing ministries and the Specialised Councils and Committees — in the formulation of objectives and strategies of the Fourth FYP.

In order to expand participation in plan preparation, the Development Council formed five committees. These were: 1) Macro-economic committee, whose task was to examine, integrate and co-ordinate the work of the other four committees; 2) Commodity (or Goods Producing) Sector committee 3) Trade and Financial Services committee; 4) Public Services committee; and 5) Human Resources committee.

The methodology for the preparation of Fourth FYP was new and distinct in three respects. First, for preparing a comprehensive and internally consistent plan, a macroeconomic model was designed for estimating the basic national aggregate variables such as gross domestic product, final consumption expenditure, savings, capital formation, exports, imports, government expenditure and revenues, etc.

Secondly, in order to speed up economic diversification and promote regional development, sectoral plans and regional plans were prepared to serve as the basis for investment programming[1] and allocation of development expenditure.

Third, the planning process was to be regarded as continuous, connecting each successive five-year plan with the long-term planning perspective covering 15 to 20 years. Hence the planners (Development Council) and the implementing agencies were expected to continuously introduce corrections in the development programmes and update the planning framework for the next five years on a regular basis in the form of a *rolling plan*[2].

Appendix 3-AI contd...

[1] As already explained, in the first three FYPs sectoral and regional distribution of investment (development expenditure) were the outcomes (results) and not the criteria (determinants) of project-based programming.
[2] However, due to technical difficulties, the concept of rolling plans did not materialise.

As in the previous three five-year plans, the unit for allocation of investment expenditure in the Fourth FYP was also individual projects (which included construction of fixed assets, facilities for education, health, training etc.). Each project was classified according to the main sector and the sub-sector which it would serve, the planning region in which it would be located and the implementing authority of the project (i.e. the ministry or department responsible for the implementation and management of project).

However, unlike previous three five-year plans, in the Fourth FYP the basis or criteria for selection of a project for inclusion in the Fourth FYP was its importance in sectoral investment plans and inter — and intra — sectoral and regional priorities. Thus the sectoral and regional distribution of public investment in the Fourth FYP was determined prior to the selection of individual projects. In other words, in the Fourth FYP, the sectoral and regional distribution of investment was the determining factor, and not an outcome of the project-based planning, as was the case in the First, Second and Third FYPs.

The Fifth FYP (1996-2000)

The Fifth FYP is a point of departure for the planning process. Having implemented four FYPs, the state in Oman initiated during 1993-95 a number of studies to carry out a detailed critical appraisal of achievements and problems of Oman during the quarter century of development experience — 1970-95. This was done with the aim of formulating a broad vision for the Omani economy for the year 2020, whose principal aim is to sustain living standards in real terms at their present level, as a minimum, and to attempt to double the present real per capita income by the year 2020. In other words, the Fifth FYP is Oman's preparation for 'take off' to the 21st century (Oman, 1996a:p.168).

The Fifth FYP differs from the previous four plans because it envisages two types of major quantitative shift in Oman's development strategy. The development process which till the Fourth FYP involved dominant, proactive and spending role of the state is now to be shifted to pivotal role of private initiative and investment under strategic guidance of the state. Secondly, development during the first four plans was based substantially on income from non-renewable resources of oil and expatriate labour, whereas from the Fifth FYP onwards development is to be based on renewable resources, and national labour.

In view of this shift in strategy, the methodology of planning is also changed. From the detailed planning of investment and project programming, the Fifth FYP entails addressing the main issues and formulating appropriate policies and strategies to tackle them. It is based on a macroeconomic model involving structure of output and demand, savings and investment, external current account, government revenue and expenditure, interaction of commodity and service sectors and forecast of alternative scenarios. It also envisages a much larger role for the private sector in capital formation in particular, and in the development process in general, as will be elaborated in Chapter VII.

CHAPTER IV

ECONOMIC AND SOCIAL DEVELOPMENT OF OMAN : A COMPARATIVE AND HISTORICAL ANALYSIS

4.1 Introduction

This chapter analyses the economic and social development of Oman during the period 1970-1995. This analysis is carried out in relation to the policies and strategies of development adopted in Oman, and within the context of the regional and global policies in which this change was achieved.

After providing a brief historical background of the initial socio-economic conditions that prevailed in Oman till the year 1970, this chapter examines the results achieved by Oman in relation to growth of income, stability of prices, export performance and trade balance, and structural change. It then proceeds to examine social development by analysing a number of indicators in the field of education, health, infrastructure and inequality. Wherever possible, Oman's socio-economic indicators are compared with those of Upper-middle-income economies[1] and countries classified as having medium human development. In addition, comparisons are also made with a number of selected developing countries.

[1] Countries are classified by the World Bank according to income. For example, countries having GNP per capita income between US$ 3,025 and US$ 9,385 are classified as Upper-middle income countries (World Bank, 1997a:pp.206-207).
Similarly, countries are classified by the UNDP according to their Human Development Index (HDI). Countries with HDI values of 0.500 to 0.799 are classified as medium human development (UNDP, 1997:p.144). Oman is classified as an Upper-middle-income economy, having medium-human development.

The chapter then analyses briefly the factors that enabled Oman to achieve considerable success in economic and social development between 1970 and 1995, particularly during the two decades of development planning, 1976-95. Before concluding, a comparative note is provided on Oman's development compared with Trinidad and Tobago and Gabon, two oil producing and small[1] countries like Oman.

The aim of this chapter also is to describe the economic and social development that has taken place in Oman so that the role of development policy and planning, the subject of the next chapter, can be analysed with specific reference to empirical evidence presented here. As we have stressed in the Introduction, a comprehensive use of statistics has been necessitated in the present chapter and also in Chapters V, VI and VII, that is the chapters dealing with the empirical analyses of Oman, by the nature of the process being analysed. Without statistical quantification Oman's economic and social development in terms of achievements and failures would be rendered rather impressionistic. A purely qualitative analyses may not be able to capture the magnitude of change in Oman.

4.2 Historical Background : Initial Conditions and the Evolution of Development Planning

As mentioned in Chapter I, the socio-political modernisation and economic development of Oman began in earnest from the year 1970, when the present ruler, H. M. Sultan Qaboos bin Said assumed office as the executive head of the state[2]. The extent of economic and social stagnation and backwardness of pre-1970 Oman is described in the Introduction and in the Appendix table 1 of Introduction. A country of about 658,000 people and spread over 309,500 sq. km. had in 1970 only 10 kilometres of asphalt roads, 3 schools with 909 students, 12 hospital beds, meagre supplies of electricity and water, and about 1 telephone line for every 1,000 persons. Oman's gross domestic product in

[1] Small in terms of the size of their population.
[2] The predecessor and father of Sultan Qaboos, Sultan Said bin Taimur who ruled the Sultanate of Muscat and Oman from 1932 was deposed and abdicated in favour of his son on July 23, 1970 (Oman, 1994b).

1970 at current prices was RO 104 million and per capita nominal GDP was about RO 158 (Oman, 1996c:pp.4-5).

One of Oman's immediate concerns after 1970 was the establishment of the institutions required to initiate a process of economic and social development. These institutions were established in phases during 1970-74. First, a modern administration was established to carry out the different administrative and executive functions of government in general, and to plan and execute the economic development schemes in particular[1]. Second, in order to initiate a process of rapid economic and social development, a Supreme Council for Economic Planning and Development was set up in 1972, which was superseded in 1974 by the creation of the Development Council[2]. The main functions of the Development Council were to set objectives and a strategy for economic development, to propose policies and measures to carry out these objectives and to lay down development plans in harmony with these (Oman, 1976a:pp.8-11).

Prior to the introduction of development planning and commencement of the First FYP in 1976, the task of promoting development was carried out on the basis of the implementation of individual developmental projects which were formulated without reference to a wider framework of the economy. However by early 1974, lack of co-

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[1] On 28th June, 1975 the Law of Administrative Organisation of the Government was issued by Royal Decree no.26/1975. The Law defined the means of organising the government administration and the powers and functions vested in the heads of the administrative units (Oman, 1976a:pp.115-124.)

[2] The economic planning and development units underwent several changes between 1970-1974. Following his accession, The Sultan dissolved the Development Board formed by his father and formed the Department of Planning and Development. The temporary Planning Council which was formed in the early 1970s was replaced in 1972 by the Supreme Council for Economic Planning and Development. In April 1973, a General Development Organisation was formed which was replaced in November by the Ministry of Development. In November 1974, the Ministry of Development was dissolved and in a cabinet reshuffle, a number of ministries were created to take over its functions. At the same time, to separate executive functions from planning, the Development Council was formed. By 1976, the structure of the government organisation comprised the Council of Ministers presided by H. M. The Sultan and four specialised councils: The Development Council, The Financial Affairs Council, The Natural Gas Council, and The Defence Council (*ibid.*:pp.8-10). The Development Council was dissolved in 1996 and its responsibilities were transferred to the Cabinet (Oman, 1996g).

The Ministry of Development before its dissolution in 1974 combined both planning and executive functions relating to sectors of agriculture, irrigation and fisheries, mining and petroleum, commerce and manufacturing. In 1994, a new Ministry of Development was formed.

ordination between different projects, on the one hand, and, on the other, between the Ministry of Finance (which funded the projects) and the ministries implementing these projects led to a deep financial crisis. A large number of projects had been initiated without budgetary cover. Therefore, one of the first tasks of the Development Council was to carry out a full and detailed appraisal of all ongoing development projects and to ascertain their budgetary implications *(ibid.)*.

From 1976 to the present, economic and social development is being promoted through a series of five-year plans. Four five-year plans have been completed between 1976 and 1995. Currently, the Fifth FYP (1996-2000) is in the process of implementation.

The underpinnings of the successive five-year plans have been provided by the objectives[1] of Oman's long-term development strategy which the Development Council, keeping in view the longer term perspective of 15 to 20 years, had announced in 1975. However, apart from these long-term strategic objectives, each successive five-year plan contains a set of its own medium-term objectives to be achieved through investment programming, and economic, fiscal and monetary policies specifically provided in each of these plans.

Since Oman started exporting oil in 1967 (Al Yousef, 1995:p.28), oil has continued to be the prime mover of Oman's economic growth and though, as we shall see later, in the last two decades Oman's dependence on oil has declined, Oman continues to remain a primary resource-based, mono-export economy with the petroleum sector (crude oil and gas) providing in 1995 about 77 per cent of government revenues[2], around 38 per cent of nominal gross domestic product and more than three-quarters of total exports (Oman, 1996b). However, Oman's oil reserves, even after new discoveries, have been

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[1] These are: to achieve sustained improvement in peoples' quality of life, expansion and diversification of the non-oil sectors of the economy, to reduce dependence upon oil exports, establishment of a country-wide network of modern infrastructures, development of local (Omani) human resources to reduce dependence on immigrant labour force, promotion of freely competitive markets and free trade, promotion of equality in regional and personal incomes (Oman, 1976a:pp.3-5).

[2] Government revenues are net of transfers to state reserve funds.

quite small, relative to both the world oil reserves[1] (Al Yousef, 1995:p.50) and in terms of their average expected life which was estimated to be 12 years in 1975 and 16 years in 1995 (Appendix table 4-AII).

Thus Oman's meagre oil resources, compared to its neighbours and the initial conditions of stagnation and backwardness prevailing in the early 1970s led Oman to adopt development planning as a means to achieving socio-economic transformation. The policy makers in Oman could not rely on the neo-classical approach, as discussed in the previous three chapters — marginal adjustments and piecemeal improvements to patch up the market — because such an approach would have been unable to jerk such an underdeveloped economy out of the vicious circle[2] of low rates of savings and investment in the face of rapid population growth. This could only be done by mobilising resources, internal and external, through government intervention, to launch a "big push" in the form of a massive investment programme.

However, as we shall see later and as we discussed in the preceding chapters, while Oman rejected the neo-classical approach to development, it did not supplant the market. Instead, it used planning as a means of developing the market mechanism and promoting an active private sector.

4.3 An Assessment of Oman's Economic Development

Oman's economic development is assessed by examining a number of leading indicators. These are: the growth of national income and per capita income; control of inflation and public debt; export performance and trade balance; structural change and

[1] Oman's share in the world oil reserves was only 0.5 per cent in 1995 compared to Saudi Arabia's share of 25 per cent and UAE's share of 9 per cent (OPEC, 1996:p.36).

[2] As we discussed in Chapter II, both Rosenstein-Rodan (1943 and 1961) and Nurkse (1953) observed that in an underdeveloped economy, characterised by a 'vicious circle of poverty' the investment programme must be both massive and balanced. Moreover, Nurkse (1953) advocated that the onus of breaking out of the vicious circle rests firmly on the government not only for launching the investment programme, but also for mobilising both domestic and foreign resources to fund the programme.

sectoral composition of GDP. We shall also attempt to compare Oman's experience with other selected developing countries[1].

4.3.1 Growth of national income[2] and per capita income : 1970-95

As we noted in Chapter II, in strictly economic terms 'development' has traditionally meant the capacity of a national economy, whose initial economic conditions have been more or less static for a long time, to generate and sustain an annual increase in its gross national product.

Using this criteria, it can be seen from tables 4.1 and 4.2 that Oman achieved considerably rapid growth in terms of its nominal GDP ever since it started its development in the 1970s. Between 1970 and 1995, GDP at current market prices grew by as much as 51 times (or 5,004 per cent), i.e., it increased from RO 104 million to RO 5,288 million recording a compound average annual growth rate of 17.0 per cent during the period.

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[1] These are the countries either falling within the Upper-middle-income group, or are oil exporting countries, or are countries with good development performance such as China and Botswana.

[2] National income is measured by gross domestic product or gross national product. Gross domestic product is the sum of the gross value-added by all resident and non-resident producers in the economy plus any taxes and minus any subsidies not included in the value of the products. While GNP is the sum of GDP plus (or minus) the net receipts (or payments) of primary income-employee compensation and property income — from non-resident resources (World Bank, 1997b:p.19 and p.133).

Table 4.1

Growth of GDP and per capita income at current and constant prices - (1970-95)

Year	Population estimate[a] (000)	GDP at current prices[b] (RO Mn.)	GDP at constant 1988 prices[b] (RO Mn.)	Per capita GDP at current prices (RO)	Per capita GDP at constant prices (RO)	GDP deflator	Index of GDP deflator[c] (1980=100)
1970	658	103.6	-	158	-	-	-
1975	824	721.8	-	876	-	-	-
1980	1052	2,063.5	1,382.9[d]	1,962	1,315	149.2	100.0
1985	1,408	3,590.6	3,124.2	2,550	2,218	114.9	77.0
1990	1,626	4,493.0	3,599.0	2,763	2,213	124.8	83.7
1995	2,135	5,288.2	4,772.7	2,477	2,236	110.8	74.3
Cumulative growth rates (%)							
1970-95	224.5	5,004.0	-	1,467.7	-	-	-
1975-95	159.1	632.6	-	182.8	-	-	-
1980-95	102.9	156.3	245.1	26.3	70.1	-25.7	-25.7

Notes:

a) Data from Oman (1996c) *Socio-Economic Atlas.*

b) In 1995, the Ministry of Development, based on a number of socio-economic surveys, updated all GDP estimates for the years 1980-94, both at current and constant prices to correspond with U. N. System of National Accounts (SNA, 1993). The main change was in GDP estimates at constant prices. Therefore, data from 1981 onwards are based on the new SNA.

c) GDP deflator shows annual price movements for all goods and services produced in the economy (and included in GDP). It is obtained by the ratio of GDP at current prices to GDP at constant prices in national currency (World Bank, 1996:p.226).

d) In order to provide inter-plan comparisons till 1980, GDP estimates for 1980, both at current and constant prices, have been recalculated using the old National Accounts Methodology. Under the 1993 SNA, GDP estimate for 1980 at current prices is RO 2,185 million and at constant prices, it is RO 1,619 million. All GDP estimates used here are at market prices and not at factor cost.

Source: Compiled from Oman (1986b and 1996b) *Statistical Year Book 1985 and 1995.*

Table 4.2

Average annual growth rates of GDP[a] and per capita income at current and constant prices - (1970-95)

(per cent)

Period	GDP - average annual growth rate (%)		GDP per capita - average annual growth rate (%)	
	At current prices	At constant 1988 prices	At current prices	At constant prices
1971-75	47.3	-	41.0	-
1976-80	23.4	-	17.5	-
1981-85	11.7	17.7	5.4	11.0
1986-90	4.6	2.9	1.6	-0.1
1991-95	3.3	5.8	-2.2	0.2
1981-95	6.5	8.6	1.6	3.6
1976-95	10.5	-	5.3	-
1971-95	17.0	-	11.6	-

Note:

a) Data for GDP are at market prices (inclusive of imputed bank charges and indirect taxes) and not at factor costs.

Source: Derived from table 4.1, average annual growth rates are average compound growth rates.

Before development planning commenced in 1976, that is, between 1970 and 1975, the nominal GDP grew by as much as 7 times mainly because of the increase in the average oil price in 1974 and the consequent buoyancy in the non-oil sector[1]. Another reason for such a large increase in GDP in a short span of time was due to a massive investment programme undertaken by the government in the initial period, when the economy was in a state of relative stagnation.

[1] The average oil price which was US$ 1.8 per barrel in 1970 rose to US$ 3.6 in 1973 and then to US$ 12.3 per barrel in 1974 (Oman, 1976b). Also see Appendix table 4-AII.

Under the two decades of development planning — from 1976 to 1995, the average annual growth rate in nominal GDP has been similarly quite high at 10.5 per cent, with GDP growing by almost 633 per cent — from RO 722 million in 1975 to RO 5,288 million in 1995.

However, the growth of nominal GDP experienced in the successive five-year periods, corresponding to the four five-year plans, indicates that the average annual growth rates from the First FYP period to the Fourth FYP have shown a declining trend. Whilst the average annual growth rate in nominal GDP was as high as 23.4 per cent between 1976 and 1980, it fell to 11.7 per cent during 1981-85. Whereas between 1986 and 1990, the growth rate declined further to 4.6 per cent and during the period 1991-95 (the period of the Fourth FYP), it was still lower at 3.3 per cent. However, as we shall see in Chapter V, part of the reason for the declining trend in growth rates has been due to the continuous decline in the oil price since 1980, resulting in deterioration of Oman's terms of trade.

Another reason which can be responsible for the decline is due to gradual economic maturity. In the initial stages of development, it is possible to achieve relatively high rates of growth, since the economic base is low and there are plenty of idle resources. As experience of other developing countries shows, it becomes much more difficult to maintain high growth rates in later phases of development, especially in an unfavourable international economic environment — as has been the case with Oman in the period of declining oil price.

A notable feature of Oman's growth experience is that for the 15 year period, 1981-95, the performance of the economy in real terms was much better than in nominal terms. Reflecting Oman's low rate of inflation during this period, the average growth in real GDP (at 1988 constant prices) was considerably higher than the growth in nominal GDP. As table 4.1 indicates, while the real GDP increased from RO 1,383 million in 1980 to RO 4,773 million in 1995, thereby recording an increase of about 245 per cent during the period, the nominal GDP grew from RO 2,064 million to RO 5,288 million between these two years, thereby recording an increase of about 156 per cent only during the same period.

During the twenty-five year period, 1970 to 1995, as table 4.1 indicates, GDP per capita at current prices increased by about 15 times from RO 158 to RO 2,477, giving an average annual growth rate of 11.6 per cent. During the two decades of development planning, 1976-95, nominal GDP per capita grew by 183 per cent, recording an average annual growth rate of 5.3 per cent.

Since the nominal GDP is greatly influenced by the oil price and hence is beyond Oman's control, it is important to examine the developments in real GDP. As tables 4.1 and 4.2 show, over the 15 year period, 1981-95 real GDP per capita grew by about 70 per cent — from RO 1,315 to RO 2,236 — whereas nominal GDP per capita increased by 26 per cent from RO 1,962 to RO 2,477 because the inflation rate was negative in 9 out of 15 years and the index of GDP deflator (1980=100) declined during 1980-95 by about 26 percentage points. Thus the average annual growth rate in real GDP per capita during this period covering the Second, Third and Fourth FYPs was higher at 3.6 per cent, compared to the average annual growth rate of 1.6 per cent in nominal GDP per capita.

Comparing Oman's rates of growth with other developing countries, as table 4.3 shows, Oman recorded comparably high rates of growth in GDP[1] compared to the group of Upper-middle-income countries and the world as a whole. For example, during the period 1965-80, Oman's growth rate was more than three times the average growth rate in the world, while during the period 1980-90, it was more than two and half times that of the world, and during the period 1990-95, it was three times higher.

[1] All growth rates shown in the *World Development Reports* and the *World Development Indicators* are computed from constant or real price series (World Bank, 1997b:p.xxiv).

However, a comparison with Oman's growth rates with those of individual countries reveals a slightly different picture. Whilst only Botswana achieved higher average annual growth rates than Oman during 1965-80, Oman recorded lower growth rates than a number of other developing countries during 1980-90. As table 4.3 shows, Botswana, China and South Korea all recorded higher average annual growth rates during that period, although Oman achieved the fourth highest growth rates among the 148 economies with populations of more than one million listed in the *World Development Indicators* (World Bank, 1997b:pp.130-132). Similarly for the period 1990-95, in addition to China, Chile, South Korea and Malaysia which recorded much higher average annual growth rates than Oman, there were other ten developing economies out of the 148 economies mentioned earlier, like Jordan, Indonesia etc., which also recorded higher growth rates than Oman during that period (*ibid.*).

Table 4.3

Average annual growth rates in GDP, 1965-95 (at constant prices)

Oman compared with the world and selected developing countries

(per cent)

Region/Economy	**1965-80**	**1980-90**	**1990-95**
Oman	13.0	8.3	6.0
Upper-middle-income	5.6	1.3	2.6
World	4.1	3.1	2.0
Botswana	14.2	10.3	4.2
China	6.4	10.2	12.8
Chile	1.9	4.1	7.3
Gabon	9.5	0.5	-2.5
South Korea	9.6	9.4	7.2
Saudi Arabia	11.3	-1.2	1.7
Malaysia	7.3	5.2	8.7

Source: Column 1, World Bank (1990) *World Development Report 1990*, pp.180-181; Columns 2 and 3, World Bank (1997b), *World Development Indicators 1997*, pp.130-132.

Because of Oman's heavy reliance on expatriate labour, (a point we shall discuss in Chapters V and VII) and purchase of services from abroad, it is also important to examine its performance in terms of GNP[1]. Another important element for comparison is the rate of population growth since it also influences per capita income growth. Since Oman is in the second stage of its demographic transition[2], modernisation associated with improved public health measures has led to a marked reduction in mortality rates and increased life expectancy, while such improvements have not yet been accompanied by a decline in fertility rates[3]. The growing divergence between high birth rates and falling death rates has led to a sharp increase in population growth, while the fact that a large proportion of its population is in the young age group[4] has increased Oman's reliance on expatriate labour.

The impact of Oman's high population growth rate on growth of GNP per capita is shown in table 4.4. Along with Botswana and China, Oman during the period 1980-93 achieved almost the highest growth rates in GNP among the 174 economies listed in *Human Development Report 1996* (UNDP, 1996:pp.186-87). But Oman's rate of growth of GNP per capita was much lower than these two countries during this period. While GNP per capita in Botswana grew at 6.2 per cent and in China, it increased at the rate of 8.2 per cent, Oman achieved an average annual growth rate of 3.4 per cent in its GNP per capita due to its high population growth rate. In fact, in addition to the five countries shown in the table below, there were fourteen other developing countries that recorded higher GNP per capita annual growth rates during 1980-93 (*ibid.*). Although Oman's per capita income growth was in line with the world average, it was very much below the annual average growth rate of 5.5 per cent achieved by the group of countries with

[1] This is the sum of gross value-added by all *resident* producers plus any taxes (less subsidies) that are not included in the valuation of output plus net receipts of primary income from *non-resident sources* (World Bank, 1997b:p.19) (emphasis added by the present author).

[2] According to the theory of demographic transition, population growth, as a function of (real) per capita income passes through three stages. In the first stage of a traditional society with low per capita income, population growth is quite low because both birth and death rates are high. In the second stage, as per capita income grows with development taking place, population growth tends to be high because while the birth rate remains high, death rate declines rapidly with spread of modern medicines, public sanitation and education. In the third stage of a developed economy enjoying high per capita income, both the birth and death rates are low and hence population growth tends to be quite low (Todaro, 1992:pp.214-217).

[3] This point is discussed further in Chapter VII.

[4] As we shall see in Chapter VII, about 52 per cent of Oman's population were below the age of 14 in 1993 (Oman, 1993a:p.39).

medium-human development. This is, as can be seen from table 4.4, due to Oman's much higher population growth rate. However, Oman's performance was much better than Saudi Arabia, which also has a high rate of population growth, but has a much larger oil income. Whilst Saudi Arabia's GNP per capita grew by only 0.6 per cent during the period 1965-80, and declined by 3.6 per cent during 1980-93, Oman's GNP per capita grew by 9.0 per cent and 3.4 per cent respectively during these two periods.

In absolute terms, Oman's GDP[1] has grown from US$ 5,982 million in 1980 to US$ 12,102 million in 1995 while its GNP per capita reached US$ 4,820 in 1995 (World Bank, 1997b:pp.9 and 135).

[1] GDP is always calculated by the World bank at purchasers' prices. And all dollar figures are current US dollars unless otherwise stated (World Bank, 1997b:pp.xxi).

Table 4.4

GNP, GNP per capita and population : average annual growth rates (1965-2000)

Oman compared with the world and selected developing countries

(per cent)

Economy/Region	GNP	GNP per capita		Population	
	1980-93	1965-80	1980-93	1960-93	1993-2000[a]
Oman	9.3	9.0	3.4	3.9	4.0
World	2.8	3.0	3.3	1.9	1.5
Medium-human development	4.9	3.9	5.5	2.1	1.4
Botswana	9.5	9.9	6.2	3.3	3.0
China	9.6	4.1	8.2	1.8	1.0
Chile	4.6	NA	3.6	1.8	1.5
Gabon	0.1	5.6	-1.6	2.9	2.8
South Korea	8.7	7.3	8.2	1.7	0.9
Saudi Arabia[b]	-	0.6	-3.6	4.4	3.1
Malaysia	6.4	4.7	3.5	2.6	2.1

Note:

a) Estimated growth rates.

b) Data for GNP growth for 1980-93 are not available.

Source: UNDP (1996) *Human Development Report 1996*, pp.178-179; 186-187.

4.3.2 Control of inflation and public debt

Unlike many other developing economies, including the oil exporting ones, Oman has been able to control inflation[1] for more than a decade. As we shall discuss in Chapters V and VI, this is partly due to the fact, and that Oman has never relied on inflation tax[2] to finance fiscal deficits because the deficits have been within financeable limits.

As chart 4.1 below shows Oman had a high average annual inflation rate (of 25 to 30 per cent) during the period 1970-80, due to the emergence of the economy in 1970

[1] International experience suggests that macroeconomic stability entailing maintenance of inflation rate below 20 per cent (World Bank, 1993b:p.110) — a level not crossed by Oman since the late 1970s — for long periods is a corollary to fiscal prudence.

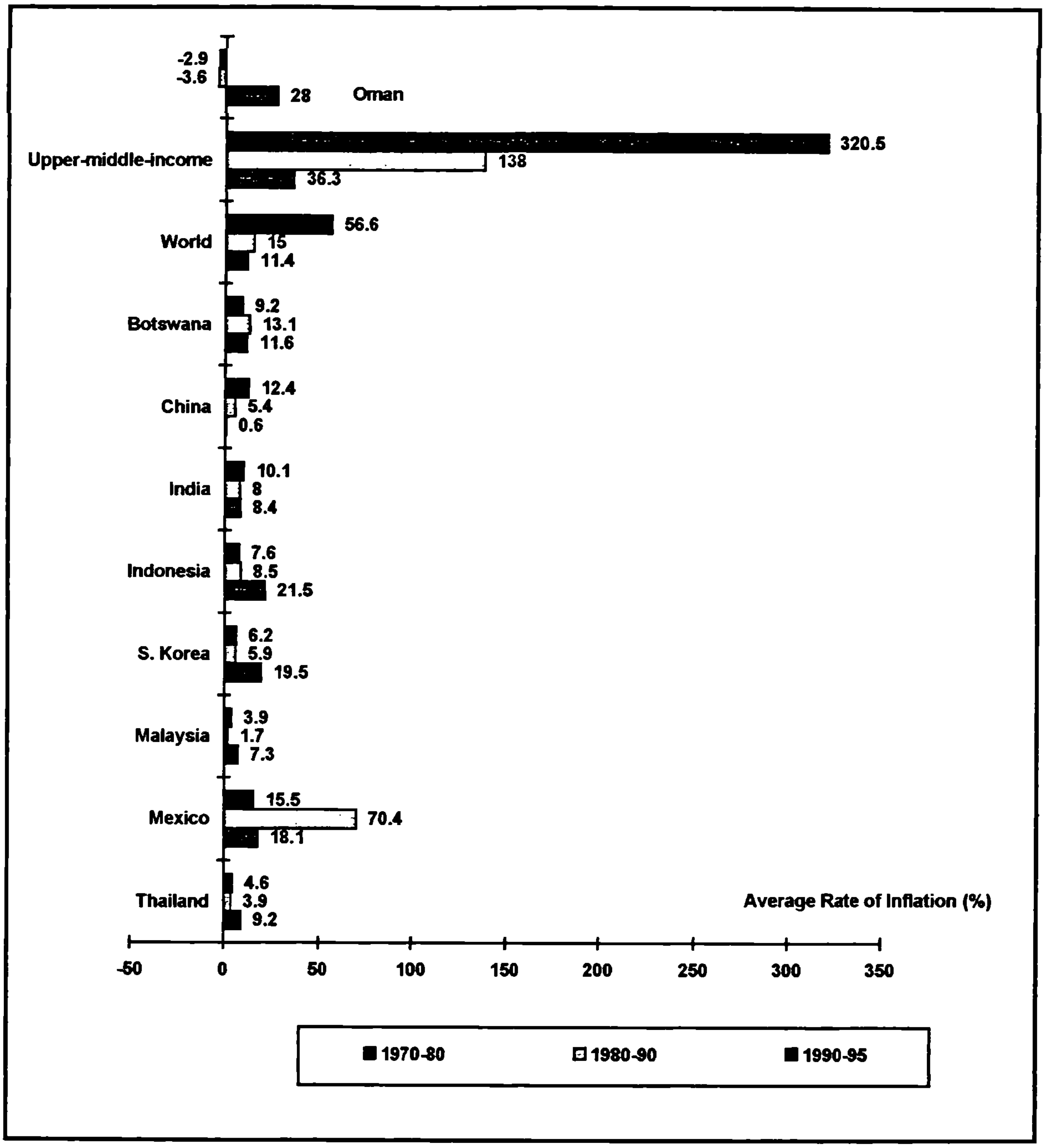
[2] That is, to increase the money supply without corresponding increase in currency reserves.

from a stagnant 'traditional' stage to a 'modern' forward-looking one. However, since the 1980s, inflation, as measured by GDP implicit deflator, has recorded a negative growth. According to the World Bank data, during 1980-90, the GDP implicit deflator in Oman recorded an average annual *decline* of 3.6 per cent, while for the period 1990-95, the average annual rate of *decline* was 2.9 per cent (World Bank, 1997b:p.207).

Comparing Oman's inflation rate with other countries in the Middle East and North Africa, the *World Development Indicators* (*ibid.*) identified Oman as having the lowest rate of inflation in this region during the period 1990-95.

Chart 4.1

Average annual rate of inflation (%) : Oman compared with selected economies (1970-95)



Source: World Bank (1995a:pp.162-163; 1997b:pp.207-208), *World Development Indicators 1995; 1997.*

There are several reasons for Oman's success in keeping the rate of inflation at very low levels during 1980-95. These include: firstly, revenues from oil exports enabled Oman to have a very liberal import policy, with a minimum level of customs duty — not exceeding 6 per cent[1] for most of the items — with food items and building materials being exempt, quota restrictions are almost non-existent. Therefore, shortages in domestic production of tradables are compensated for through imports.

Secondly, protection for infant industries was not only very selective but, in most cases, it took the form of increased custom duty — about 25 per cent of the value of competing imported goods — instead of import quotas and bans, which were the norm in a number of developing countries. However, although the protection provided by the developing countries to domestic industries under the import-substituting industrialisation strategy has come under heavy criticism since the 1970s (as discussed in Chapters I and II), we would argue that the absence of such protection for domestic industries has been one of the reasons for Oman's limited success in diversifying its economy. This point is discussed further in Chapter VII.

Thirdly, although development planning was adopted as a means of transforming the economy and society, the government, in line with its policy of promoting the market and working in tandem with it, relied almost exclusively on the markets in trade and production by adopting a 'market-oriented' strategy. This was very clearly emphasised in the development strategy referred to earlier. And lastly, foreign exchange earnings brought in by oil exports enabled Oman to adopt a liberal exchange rate system and at the same time maintain a stable currency.

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[1] These have remained unchanged throughout the period 1983. For example, Oman's mean tariff during 1989-93 was 5.7 per cent, with standard deviation of tariff rates not exceeding 9.2 per cent during that period (World Bank, 1997b:p.253).

In the case of public debt, Oman's conservative borrowing policy has ensured self reliance in financing the development process. Thus despite large fiscal deficits[1], Oman's total external public debt has remained low compared to some other oil exporting developing countries like Mexico and Nigeria which borrowed heavily during the years of the second oil price increase of (1979-80) for ambitious development programmes[2], in expectation of continued increases in oil revenues, (James, *et. al.*, 1989:p.107). Oman has been able to resist this temptation. As table 4.5 shows, in 1995, the present value of Oman's external public debt, amounting to 45.8 per cent of its exports of goods and services and 28 per cent of its GNP, was low compared to a number of selected developing countries and the group of Upper-middle-income economies. As a result, in 1995 its total debt service ratio of 7.5 per cent of exports of goods and services, and of 4.6 per cent of its GNP was accordingly very low. While there are no absolute rules on what values are too high for these ratios, according to the *World Development Indicators* (World Bank, 1997b), empirical evidence has shown "[t]hat debt service difficulties become increasingly likely when the ratio of the present value of debt to exports reaches 200-250 per cent and the debt service ratio exceeds 20-25 per cent"(*ibid.*:p.225).

[1] As we shall see in Chapter V, Oman's fiscal deficits during the Third and Fourth FYP have been large by developing countries standards.

[2] As we discussed in Chapter I, the large expansion in external borrowing by a number of developing countries in the 1970s led to a debt crisis in the 1980s which in turn provided the pretext for neo-classical re-emergence and the adoption of the neo-liberal agenda by the IFIs.

Table 4.5

External debt management : Oman compared with selected developing economies

Economy/Region	Present value of debt as %				Total debt service as %			
	of GNP		of exports of goods and services		of GNP		of exports of goods and services	
	1993	1995	1993	1995	1980	1995	1980	1995
Oman	26.5	28.0	43.4	45.8	4.7	4.6	6.4	7.5
Upper-middle-income economies[a]	26.3[a]	-[b]	110.3[a]	-[b]	3.6	4.9	-[b]	19.4[a]
China	17.5	16.4	84.2	70.6	0.5	2.2	8.4	9.9
Chile	43.8	41.3	156.9	138.5	10.2	7.8	43.1	25.7
Botswana	13.4	13.1	-	-	1.7	2.2	2.1	3.2
Malaysia	37.6	38.6	42.1	33.6	4.0	8.1	6.3	7.8
Morocco	73.9	61.7	206.8	180.7	7.9	11.3	33.4	32.1
Mexico	33.0	67.2	174.2	163.8	5.8	9.9	44.4	24.2
Nigeria	109.9	132.3	240.6	88.8	1.3	6.3	4.1	12.3

Note:
a) Data relate to 1993 and are from World Bank (1995a:p.207) *World Development Report 1995.*
b) Data for certain years are not available for the Middle-income (Lower and Upper-middle-income) groups.

Source: World Bank (1997b:pp.222-224) *World Development Indicators 1997.*

In addition to the external public debt of RO 1,000 million, Oman has also an internal public debt of RO 377 million, thus bringing total public debt to RO 1,376 million[1], as at end of 1995 (Oman, 1996a:p.94). Oman's low public debt has provided it with the flexibility for carrying out a structural adjustment programme without the involvement of IFIs, as we shall discuss in Chapter V. Moreover, the low indebtedness makes Oman a good credit risk[2] and hence enables it to borrow at favourable terms from the international financial markets; this in turn enables Oman to pursue privatisation as a means to an end rather than as an end in itself, as we shall discuss in Chapter VII.

[1] Does not include short-term borrowings by the treasury. If these were included, total public debt would amount to RO 1,500 million as at end of 1995.
[2] As per Standard and Poor's sovereign long-term debt rating, Oman has been awarded a BBB-rating.. Ratings of AAA through BBB are categorised as investment grade. While ratings of BB through C are specified as speculative grade (World Bank, *op. cit.*:265-267).

The terms of Oman's external borrowing also compare very favourably with those of Middle-income group of countries. In 1993, for example, the average interest rate for Oman was 4.5 per cent per annum, while the average rate for the Middle-income countries was 6.7 per cent; the average maturity for Oman was 16.8 years while for the group it was 12 years (World Bank, *op. cit.*:pp.249).

On the one hand, controlling public debt to ensure macroeconomic stability, and on the other, avoiding "crowding out" of private investment through excessive public sector borrowing, has always been a main element in Oman's development policy. Thus, for example, the Fourth FYP stipulated that external public debt throughout the plan period (1991-95) should remain at the same level as at the end of the Third FYP. Additional net external borrowing could not be resorted to without the approval of the Council of Ministers (Oman, 1991a:p.409). Similarly, the Fifth FYP (1996-2000) has frozen the total public debt (external and internal) at the level of RO 1,500 million throughout the plan period, which was the stock of total public debt as at end of 1995 (Oman, 1996a:p.566).

4.3.3 Oman's export performance and trade balance

In line with Oman's long-term development strategy of promoting a free market, the government has adopted a free trade regime with relatively low tariffs and without other protectionist measures, as table 4.6 shows. There are no taxes on exports and the Omani Rial is a freely convertible currency. Thus, Oman's trade policies compare favourably with the policies adopted by those developing countries, which are classified in the 1987 *World Development Report* as "moderately outward oriented countries" (Appendix table 4-AI). However, Oman's performance in achieving structural change in its export trade has been poor compared to other countries. As the table below shows, in the case of export growth, Oman's annual average growth rate of 6.3 per cent during the period 1988-89 to 1993-94 has been almost 60 per cent lower than that of Thailand and Malaysia, countries classified as moderately outward oriented. Similarly, Oman's market share of its traditional exports has declined at an annual average rate of 2.4 per cent whereas the other four countries in table 4.6 have raised their market share in traditional exports at the rate of 1.0 to 3.4 per cent. Because of the constant decline in Oman's terms of trade, the ratio of its trade to GDP in real terms has been declining at an annual average rate of 1.61 per cent since the period 1981-83.

Table 4.6

Trade performance, trade policies, competitiveness and GDP growth : Oman compared with a selected number of countries (1980-1995)

Item	Oman	Malaysia	Chile	Tunisia	Thailand
Growth of merchandise trade					
Export volume - (1990-95)[a]	9.8	17.8	10.5	7.7	21.6
Import volume (1990-95) [a]	18.5	15.7	14.5	6.4	12.7
Net barter terms of trade [b] (1987=100) 1995	77	92	94	91	100
Income terms of trade[b] (1987=100) 1995	151	229	153	155	352
Trade policies : All Products (1990-93)					
Mean tariff %	5.7	14.3	11.0	30.0	23.1
Standard deviation of tariff rates[c]	9.2	14.0	0.7	11.7	16.9
Covered by non-tariff barriers (%)	-	2.1	0.1	32.7	5.5
Export competitiveness					
Nominal export growth 1988-89 to 1993-94 (%)					
Annual average	6.3	17.0	7.7	9.8	17.4
from world demand	8.0	8.7	3.1	5.8	8.7
from market share	-2.4	1.9	1.6	3.4	1.0
from export diversification	0.9	5.6	2.8	0.3	6.8
Integration with the global economy)					
Real trade as a share of GDP[d]					
Initial level % (1981-83)	45.7	51.3	31.0	42.3	24.6
Annual average difference from 1981-83 to 1990-93	-1.61	5.74	0.97	-0.27	3.25
Manufactured exports as a share of total exports					
Initial level % (1981-83)	4.2	20.8	8.4	36.9	27.7
Annual average difference 1981-83 to 1991-93	0.6	3.80	0.59	3.34	3.83
Gross domestic product					
Average annual % growth					
1980-90	8.3	5.2	4.1	3.3	7.6
1990-95	6.0	8.7	7.3	3.9	8.4

Notes:

a) Average annual % growth.

b) Net barter terms of trade are the ratio of the 1987 (base year) export *price* index to the corresponding import *price* index; while income terms of trade are the ratio of the 1987 (base year) export value index to the corresponding import price index (World Bank, 1997b:p.157).

c) Standard deviation of tariff rates measures the average dispersion of tariff rates around the mean (*ibid.*:p.255).

d) Real trade is the sum of exports and imports of goods and services measured in constant prices (*ibid.*:p.295).

Source: Compiled from *World Development Indicators 1997* (World Bank, 1997b:tables 4.1, 4.7, 5.6, 5.7 and 6.1).

The question which arises is: why, in spite of liberal trade policies, Oman's export performance is poorer than that of other outward-oriented countries? The study carried out by Syrquin and Chenery (1989) suggests that small, outward-looking and manufactures-oriented countries had the highest growth rates of per capita income over the sample period (1950-83); and that outward orientation led to faster rates of growth for both large and small countries, whether oriented to primary or manufactured activities. However, Oman shows different results because, as we noted earlier, it adopted mainly a *laissez-faire* approach towards industrialisation.

Perhaps the answer lies in the fact that in contrast to the East Asian countries like South Korea who carried out a 'hands on' intervention policy, Oman had relied on liberal trade policies. While in the case of South Korea, as Evans states "[t]here has been much more import substitution induced by targeted, made-to-measure protection than is captured by the available indices of protection" (Evans, 1989:p.297). Similarly, as Evans argues, the typically applied rules of thumb in evaluating infant industry protection[1] "would seem to be much too conservative, judging at least from the historical experience of South Korea and Taiwan" (*ibid.*:p.309). Equally important, as reported in Aghazadeh and Evans (1988), is macroeconomic management of both the exchange rate and of income distribution. In the case of the exchange rate, although the fixed parity of the Omani Rial *vis-à-vis* the US dollar has provided exchange rate stability, the issue is whether Oman can afford such an exchange rate stability and whether the present parity is conducive for export promotion. And a similar question relates to Oman's ability to sustain the present parity when its net barter terms of trade have deteriorated by about 23 per cent since 1987, as table 4.6 shows.

Associated with the question of trade and global integration are the changes in Oman's trade and current account balances with the external world. Although Oman has

[1] That is, a learning period of about five years and a maximum effective protection of 10-20 per cent, optimally administered through subsidies rather than tariffs or import controls (*ibid.*).

been able to protect oil revenues from the adverse consequences of deterioration in its terms of trade by increasing oil production and minimising its domestic consumption, its continued reliance on the purchase of services from abroad is clearly unsustainable. As table 4.7 below demonstrates, Oman's average trade surplus (exports minus imports of merchandise) has remained fairly constant at around RO 2,900 million for each of the successive five-year plan periods since 1981, but its current account has on average recorded a significant deficit during the period 1991-95. A 'hands on' government policy, no doubt, is warranted to adjust the worsening balance of payment situation if macro-economic stability, in terms of low inflation and a freely convertible currency, is to be maintained.

Table 4.7

Oman's balance of payments : trade and current account balances (1976-95)

(RO Million)

Item	**1976-80**	**1981-85**	**1986-90**	**1991-95**
Trade balance	1,350	2,959	2,901	2,877
Less: (a) payment for other services	514	994	1,081	1,551
(b) expatriate remittances	436	1,182	1,413	2,657
Current account surplus(+) or deficit(-)	**+400**	**+783**	**+407**	**-1,331**

Source: Compiled from Oman (1986b; 1996b) *Statistical Year Book 1985 and 1995.*

Despite the substantial trade surplus, the current account has been in deficit during the period 1991 to 1995 mainly as a result of rapid growth of expatriate remittances. The negative impact of these large remittances is also reflected in the decline in national savings. As we shall see in Chapters V and VII, while the ratio of Oman's domestic saving to GDP is high, Oman's rate of national savings is quite low and it is this issue that needs to be addressed by the New Development Strategy.

4.3.4 Structural change and sectoral composition of GDP

An important indicator of Oman's economic development is the structural change which has taken place in the Omani economy through achieving high average growth rates in agriculture, non-oil industry and services. As table 4.8 shows, in all the main sectors of the economy average annual growth rates achieved by Oman are impressive and very much higher than the growth rates achieved by Upper-middle-income countries. Agriculture in Oman recorded an average annual growth rate of 7.9 per cent during 1980-90, and 6.9 per cent during 1980-93, which compared to weighted average of growth rates of Upper-middle-income countries, are almost three to four times higher. Similarly, in the case of industry the annual growth rates of 10.3 per cent and 9.2 per cent, achieved by Oman during these two periods, and the growth rates of 20.6 and 17.2 per cent recorded in Oman's non-oil manufacturing sector were much higher than growth rates experienced by Upper-middle-income countries. The very high growth rates recorded by Oman's non-oil manufacturing sector, compared to the average for Upper-middle-income group can be attributed to two factors: the support this sector has received from the state throughout the two decades of development planning; and the fact that this sector in Oman started from a zero base and till as late as 1980, its relative share in GDP was only 1 per cent.

Table 4.8

Growth of agriculture, industry, manufacturing and services and their relative share in GDP : Oman compared with Upper-middle-income countries - 1970-93

(per cent)

Item	Agriculture[a]	Industry[b]	Manufacturing[c]	Services[d]
Average annual growth rate:				
Oman				
1980-90	7.9	10.3	20.6	6.0
1980-93	6.9	9.2	17.2	6.2
Upper-middle-income[e] countries				
1980-90	2.4	0.7	1.2	2.0
1980-93	1.8	2.3	2.5	2.9
Relative share of value-added[h] in gross domestic product[g]:				
Oman				
1970	16	77	0	7
1980	3	69	1	28
1993	3	53	4	44
Upper-middle-income countries[e]				
1970	12	38	25	49
1980	8	47	20	43
1994[f]	8	37	20	53

Notes:

a) Agriculture includes fisheries.
b) Industry includes oil, gas, manufacturing, quarrying, electricity, water and construction.
c) Because of the importance of manufacturing, it is also shown separately.
d) Services include all real estate, financial intermediation, trade, tourism, public administration and defence, health, education and any other activities not classified in the first three headings. Also included in services, are custom duties, while imputed bank services are deducted.
e) Data for Upper-middle-income countries are weighted averages.
f) Because aggregate data for 1993 are not available, data for 1994 have been used (World Bank, 1996:p.211).
g) The changes in the relative share of the various sectors over the period 1980-93 do not correspond to the growth rates achieved by each sector. The reason for this is, whereas average growth rates are based on *constant* 1987 prices the relative share of GDP is based on *current* US dollars (World Bank, 1996:p.232).
h) Relative shares of GDP are based on current price series; while average annual growth rates are based on 1987 constant prices (World Bank, 1995a:pp.230-232).

Sources:

1) Data relating to 1970, 1993 and *1980-93* are from World Bank (1995a:pp.164-167), *World Development Report 1995.*
2) Data relating to 1980 and 1980-90 are from World Bank (1997b:pp.130-132 and 134-136) *World Development Indicators 1997.*

As regards the relative share of these sectors in GDP, table 4.8 shows that while the value-added by agriculture in Oman recorded a sharp decline from 16 per cent to 3 per cent between 1970 and 1980, it has maintained its relative importance of 3 per cent of GDP since 1980. The decline in the importance in agriculture reflects the structural change that has been engineered by the state from the mid-1970s through adoption of one or more of the development strategies discussed in Chapter II. However, as we shall see in Chapter V, the significant decline in the relative share of agriculture is not due to its neglect by the state, but because of the limited potential for growth in this sector[1], the higher growth potential of the other sectors and the need to develop a diversified modern economy. Thus the relative share of agriculture has declined because other sectors have grown much more rapidly.

Table 4.8 also shows that while the growth in industry has been equally significant, its relative share has declined from 77 per cent in 1970 to 53 per cent in 1993. The large decline in the share of industry is a clear manifestation of the impact of global political economy on Oman's domestic economy. Thus, despite recording impressive growth rates in real terms, over the period 1980-93, the value-added by industry in nominal terms (current US dollars) has declined by about 23 per cent between 1980 and 1993 because of a continuous decline in Oman's terms of trade[2]. While in the case of services, although the growth rates recorded are lower than those recorded in industry, yet its relative share of GDP in nominal terms has increased from 28 per cent in 1980 to 44 per cent in 1993. Again, the reason for this large difference in performance of these two sectors, is because the services sector is not directly affected by the terms of trade and Oman's inflation rate

[1] This is because of scarcity of water. Oman had fresh water resources of only 911 cubic meters per capita in 1995; in comparison to South Korea, which had 1,474 cubic meters and Malaysia which had 22,642 cubic meters per capita. The average for Upper-middle-income countries was 22,930 cubic meters (World Bank, 1997b:pp.102-104). Another problem is the topography of Oman, where desert and mountains occupy almost two thirds of the land area and only 5 per cent of the land is suitable for permanent pasture, compared to the average of 32 per cent in Upper-middle-income countries (*ibid.*:pp.94-96). Moreover, the decline in the relative share of agriculture is in line with the empirical findings of Syrquin (1988) which show that while agriculture provides the initial stimulus for transformation, its importance declines with development. The share of agriculture in output and employment tends to fall with industrialisation.
[2] Oman's terms of trade declined by about 16 per cent between 1987 and 1993 (World Bank, 1995a:p.187) and between 1980 and 1986, they declined by about 63 per cent (World Bank, 1988:p.243).

has registered a continuous decline since 1980. As a result, Oman's diversification efforts have to a certain extent been frustrated by the forces operating in the centre, on which peripheries like Oman have no influence. This would be in conformity with the Centre-Periphery school which we discussed in Chapter II.

Since the diversification of the economy has been one of the principal elements of Oman's long-term development strategy formulated by the Development Council in 1975, it is necessary to focus on the activities of these three main sectors of the economy.

As can be seen from table 4.9 below, structural change in Oman has been associated with rapid growth of national income. Value-added by crude oil, representing the primary output in the case of Oman, has declined in relative importance continuously between 1976 and 1995. In 1976 the relative share of this activity in GDP at current prices was 59 per cent, when nominal GDP was RO 884 million. But in 1995 its relative share declined by about one-third to 37 per cent, when nominal GDP, had increased to RO 5,288 million.

In relation to other activities, we find that the highest growth has occurred in the value-added in manufacturing, which increased its relative share in GDP from a meagre 0.5 per cent in 1976 to 4.6 per cent in 1995. The growth in the value-added by the various services like public administration and defence, and wholesale and retail trade, has led to a large increase in the relative share of the services. As table 4.9 shows, the relative share of services in GDP has increased from 28 per cent to about 50 per cent of GDP. Although this growth reflects the rising standard of living in Oman and the wide range of services that are being provided by the economy, a point of concern, which we shall discuss briefly later and in more detail in Chapters V and VII, is that this large increase in the services sector is perhaps premature. As an oil producing country, Oman needs to diversify more into tradable sectors of the economy like agriculture and fisheries, manufacturing, and tradable services that can increase its non-oil export earnings and thus contribute towards reducing the current account deficit in its balance of payments.

Table 4.9

Structure of the economy : production at current prices - 1976 and 1995

Value-added by activity	GDP 1976 RO Mn.	GDP 1995 RO Mn.	Relative share 1976 %	Relative share 1995 %
1. Agriculture and fisheries	**18.3**	**152.0**	**2.1**	**2.9**
Agriculture	12.3	100.1	1.4	1.9
Fisheries	6.0	51.9	0.7	1.0
2. Industry	**616.7**	**2,465.6**	**69.7**	**46.6**
2.1 Crude oil	517.5	1,974.1	58.5	37.3
2.2 Natural gas	-	46.8	-	0.9
2.3 Mining and quarrying	-	17.2	0	0.3
2.4 Manufacturing	4.3	240.8	0.5	4.6
2.5 Electricity and water	6.4	49.1	0.7	0.9
2.6 Building and construction	88.5	137.6	10.0	2.6
3. Services	**244.8**	**2,625.3**	**27.7**	**49.5**
3.1 Wholesale and retail trade and restaurants and hotels	76.5	716.1	8.7	13.5
3.2 Transport and communication	13.5	332.9	1.5	6.3
3.3 Financial intermediation[a] real estate and business activities	81.1	441.1	9.2	8.3
3.4 Public administration and defence	59.5	705.6	6.7	13.3
3.5 Education	6.1	222.3	0.7	4.2
3.6 Health	3.7	92.1	0.4	1.7
3.7 Other community, social and personal services	4.4	115.2	0.5	2.2
4. GDP at producers' prices	**879.8**	**5,242.9**	**-**	**-**
5. Plus: import taxes	**4.5**	**45.3**	**0.5**	**0.9**
6. GDP at market prices	**884.3**	**5,288.2**	**100.0**	**100.0**

Note:
a) Net of imputed financial intermediation charges.

Source: Compiled from Oman (1986b:pp.396-404 and 1996b:pp.380-384) *Statistical Year Book 1985 and 1995.*

Although Oman adopted a minimal intervention policy to achieve industrialisation and did not adopt an autarkic[1] industrial policy based on import substituting industrialisation strategy, as was favoured by Prebisch (1950 and 1959) and the ECLA (as examined in the preceding three chapters), Oman's achievements in industrialisation are much below than required for effective diversification. Similarly, while Chenery's (1988:pp.205-268) study shows an increasing role for manufacturing during the transition, before the growth in services takes over and industrial maturity occurs, we find in the case of Oman, that the share of services has risen prematurely. Therefore, while the neo-classical approach focuses on "getting the prices right", one would argue that because industrialisation is a process of technological change, with learning related to experience as a major source of externality, there is no alternative to a well targeted state-led industrial strategy. As Bienefeld (1996) argues, economic liberalisation, under the present imbalances in the global political economy, is not necessarily beneficial, and protection, or intervention is not necessarily detrimental.

Comparing Oman's experience with other developing countries at a similar level of income, it is obvious from table 4.10 that the services sector has grown much more rapidly than the manufacturing and the agriculture sectors. This is a clear manifestation of the Dutch disease[2] as articulated by Auty (1995:p.66):

> The size of the competitive tradable sector (as distinct from the protected tradable sector) *vis-à-vis* the rest of the economy lies at the root of the divergent economic performance under ... alternative industrial policies. If industrial maturation is delayed ... [t]hen the burden of generating foreign exchange remains with the primary sector whose relative size shrinks as development proceeds. Moreover, the primary sector may even encourage

[1] An autarkic industrial policy (AIP) is more oriented towards inward looking industrialisation compared to an outward looking competitive industrial policy (CIP) (Auty, 1995:p.61).
[2] The concept and theory of the Dutch disease has been discussed in Chapter II.

> subsidisation of manufacturing ... [S]uch subsidies may appear to be temporarily justified in order to offset what is, in effect, Dutch disease (which manifests itself in the premature shrinkage of agriculture (*crude petroleum in the case of Oman*) and under-expansion of competitive manufacturing) (emphasis added by the present author).

Table 4.10

Structure of the economy : production : Oman compared with selected developing countries - 1994

Region	GNP per capita US$	Agriculture %	Industry %	Manu-facturing[a] %	Services %
Oman	5,140	3	53	4	44
Gabon	3,880	8	52	11	40
Malaysia	3,480	14	43	32	42
Mexico	4,180	8	28	20	64
South Korea	8,260	7	43	29	50

Note:

a) Because manufacturing is generally the most dynamic part of the industrial sector, its share is also shown separately.

Source: World Bank (1996:pp.189 and 211) *World Development Report 1996.*

The data in table 4.10 reveal that while the share of the services in Oman may be comparable with other developing countries, it is the relative share of agriculture and manufacturing that is very low. This confirms Auty's (1995) analysis that the primary sector — crude oil in the case of Oman — included under industry in the above table, is the one which bears the main burden of generating the foreign exchange required for the functioning of Oman's economy.

Thus, although Oman has succeeded in reducing its dependence on the oil sector as a source of its national income, its efforts in diversifying the non-oil sector by expanding the relative size of the (non-oil) manufacturing sector has met with only limited success. In comparison with other primary-exporting developing countries like Malaysia, Mexico and Gabon, the value-added by Oman's manufacturing industry of a mere 4 per cent is quite small. This reflects the fact that despite a favourable policy environment, there was no active policy of diversification in favour of tradables. Moreover, despite the growth constraints facing the agriculture sector, one can argue that development planning should have placed more emphasis on developing this sector. As a result, Oman has not succeeded in enhancing the non-oil exports and the burden of earning foreign exchange still falls heavily on the primary producing oil sector.

4.4 Progress in Social Development

"Ultimately", Amartya Sen argues, "the assessment of development achieved cannot be a matter only of quantification of the means of that achievement. The concept of development has to take note of the actual achievements themselves" (Sen, 1988:p.15). These "achievements" which Sen labels as "functionings" include the length of life (life expectancy), the "nature of life" and what people value as important to their well-being (nourishment, good health, clean air and water, the ability to move freely).

On the other hand, while relying on growth of national income in measuring development performance might not reveal a true picture, both Dasgupta and Weale (1992) show a strong correlation between the rankings of 48 developing countries for GNP per capita and their rankings for five other indicators (life expectancy, infant mortality, adult literacy, political rights and civil rights).

The ultimate objective of development is to improve human well-being in a substantial and sustainable way. And therefore, while discussing the meaning of development in Chapter II we stated that it is a multidimensional concept and a country's development performance has to be measured in terms of the basic indicators of human development. That is, in addition to growth of per capita income, development should be measured in terms of enhancement of people's capabilities through improvements in basic education and health care and provision of public amenities like water, electricity, roads, communication, etc. which, in a modern society, are essential for improving peoples' physical quality of life.

As stated earlier as late as 1970, Oman's level of development was very poor in terms of all the above criteria. When Oman embarked on the process of development planning, it was much more underdeveloped than the other ex-colonial developing nations in Asia and in the Middle East. Taking into consideration this background, Oman has made good progress during the last two decades (1975-1995), as table 4.11 indicates, in enhancing people's capabilities and improving their quality of life through rapid and widespread expansion of basic education and health care systems and establishment of a country-wide network of modern infrastructure.

Development of human capital is the product of education, and improvements in health and nutrition and these three elements are the most important factors which influence the development process. We will, therefore, review how the state in Oman has been able, through a series of five-years plans, to attain significant social development. We shall do so by examining the progress achieved in education, health, supportive physical infrastructure and equality. Oman's experience is also compared with a group of other developing countries[1].

[1] These are the countries classified by UNDP as having medium-level of human development like Oman, or are oil exporting countries like Oman, or are countries classified as Upper-middle-income countries by the World Bank.

Table 4.11

Main social indicators : Oman compared with Upper-middle-income countries 1970-1995

Main social indicators	1970	1995	Weighted average for Upper-middle-income countries 1995
GNP per capita US$[a]	-	4,820[a]	4,640
Average annual % growth (1970-95)	-	3.3	-
Health:	-	-	-
Infant mortality rate: per 1000 live births	119	18	35
Life expectancy at birth (years)[b]	48	70	67[c]
Population with access to[c]:			
Health services (%) 1990-95	-	96	87
Safe water (%) 1990-96	15[e]	82	69
Sanitation (%) 1990-96	-	78	36
Education:			
Gross primary enrolment ratio(% of relevant age group) 1993	4[d]	85	107
Gross secondary enrolment rates (% of relevant age group) 1993	-	61	55
Urban population (% of total population)	8[e]	13	73
Paved roads[f] (kilometre)	10	6,213	-
Normalised road index[g]	-	211	-
Private consumption (per cent of GDP)	28[e]	42	61
Television sets (per 1000 people)	-	654	256
Electricity consumption (per capita kilowatt hour)	161	3,782	895

Notes:

a) Calculated using the World Atlas method, see World Bank, (1997b:pp.18-19) for definition.

b) Data for life expectancy in 1970 and 1995 as per Omani data are 44 years and 67.6 years respectively for the two years. However, World Bank data are used here to facilitate comparison with data for Upper-middle-income countries which are based on World Bank data.

c) Data from UNDP (1997:p.164) *Human Development Report* 1997. Here the comparison is with countries classified as having medium-human-development.

d) Calculated from World Bank (1997b:p.12) *World Development Indicators 1997.*

e) Data for 1980, from World Bank (1997b:p.79).

f) Data from Oman,(1976b:p.10; 1996b:p.345) *Statistical Year Book,* 1975;1995.

g) A value of 100 is normal (World Bank, 1997b:p.279).

Source: World Bank (1997b) *World Development Indicators.* 1997 (unless otherwise indicated).

4.4.1 Education

In the field of education, a year before the beginning of development planning (i.e. 1975), there were only 183 schools (of general education) for a population of 824,000 persons. This number has increased by almost 6 times to 965 schools in 1995 to serve a population of 2,135,000 which has increased by about one and half times since 1975 (Oman, 1996b:p.581). As a result, the population per school declined by more than one-half, from 4,503 to 2,212 persons. The number of pupils in schools increased more than 10 times from 49,578 in 1975 to 490, 482 in 1995. And between 1975 and 1995 the number of teachers grew by more than 11 times from 2,115 in 1975 to 22,506 in 1995 (*ibid.*). Despite the enormous expansion in the student population in just 20 years, the student-teacher ratio did not worsen and remained constant at around 22 students per teacher. Reflecting the growth in educational services, the share of expenditure on general basic education, as a percentage of total government expenditure rose from 1.6 per cent in 1975 to 7.9 per cent in 1995 (*ibid.*).

Another important feature of Oman's education policy has been that males and females are provided equal access to all publicly provided services including education. Although in the early years, female enrolment rates were low, these have now increased to levels close to those of males. As a result, the percentage of female population in the relevant age group enrolled in primary education which was only 36 in 1980, increased to 82 in 1993 (World Bank, 1996:p.201). During the same period, the percentage of females of relevant age group enrolled in secondary education also rose from only 6 per cent to 57 per cent. Similarly the percentage of male population, in the relevant age group, enrolled for primary education also grew from 69 per cent in 1980 to 87 in 1993 and for secondary education it rose from 19 per cent to 64 per cent (*ibid.*). However, it is important to point out that Oman's gross primary enrolment ratio of 85 per cent is still below the ratio of 107 per cent achieved by countries in Upper-middle-income, but as table 4.11 shows, Oman has seriously attempted to improve the situation, because the ratio in 1970 was as low as 4 per cent.

In terms of quality of school education in Oman, a UNICEF report (UNICEF, 1994:pp.20 and 48), shows that as many as 93 per cent of female children reached at least grade 5 in 1992. This is an important indication of the improved status of women in Oman as it shows that Omani families do not have to withdraw their female children from schools for economic reasons before completing grade 5. This is unlike the situation in many developing countries. Taking both male and female children together, in 1992 the percentage of children reaching grade 5 was 91 per cent in Oman. This was higher than the 89 per cent expected from Oman, on the basis of its GNP per capita (*ibid.*).

Similarly, the ratio of female students to total students which stood at 48 per cent in 1995, corresponds closely to the percentage of females, in the Omani population, which was around 52 per cent in 1993 (Oman, 1993a:p.45).

The first University in Oman, Sultan Qaboos University at Muscat, was opened in 1986. All this progress in the field of education was possible because of progressively increasing public expenditure in Oman. Thus education's share of central government expenditure increased from 5.3 per cent in 1980 to 12.5 per cent during 1992-95, while public expenditure on education as a percentage of GNP increased from 2.1 per cent in 1980 to 4.5 during 1993-94 (UNDP, 1997:pp.180 and 186)

4.4.2 Health

As the *World Development Indicators* volume (World Bank, 1997b:p.32) state, improvements in health status and nutrition directly alleviate the worst aspects of poverty. Access of the poor to health services is important both for increasing their income (illness reduces people's capacity to work) and for raising living standards even if income remains at poverty levels. Therefore, one of the main objectives of planning policies in Oman has been to provide universal access to health services. Table 4.11 shows that compared to the Upper-middle-income countries, where about 87 per cent of the population had access to health services during the period 1990-95, in Oman the percentage was as high as 96 per cent.

As a result, and as the above table indicates, life expectancy at birth in Oman has increased from 48 years in 1970 to 70 years in 1995. This level is better than countries with medium level human development. The rate of infant mortality, per 1000 live births has also fallen rapidly from 119 in 1970 to only 18 in 1995, while the rate for Upper-middle-income countries was 35 in 1995. Similarly, the mortality rate among children under the age of five in Oman declined from 86 in 1980 (Oman, 1996d:p.3-5) to 22 in 1995, whilst the weighted average for the group of Upper-middle-income countries was 45 in 1995 (World Bank, 1997b:pp.87-88). Immunisation against measles and DPT reached a level of about 98 per cent in Oman in 1995 for children under 12 months, compared to a level of 87 per cent achieved by Upper-middle-income countries (*ibid.*:pp.79-80).

The impressive results achieved in health indicators are also reflected in the expansion of health services. We find that the number of people per physician declined from 2,142 in 1980 in Oman to 1,131 in 1995. While during the same period, people per hospital bed declined from 617 in 1980 to 398 in 1995 (World Bank, 1997b:p.75).

Table 4.11 shows that the percentage of people having access to safe water and sanitation is better in Oman compared to other similar countries; while 82 per cent of the Omani population had access to safe water and 78 per cent had access to sanitation, only 69 per cent of the population in countries with medium level of human development had access to the former and only 36 per cent had access to the latter.

4.4.3 Development of infrastructure

Peoples' physical quality of life is greatly improved by having access to easy and affordable basic public and private amenities provided through economic infrastructure in the form of electricity, piped water supply, paved (all weather) roads, post and telecommunication facilities, etc. Considering that in 1970 Oman had extremely poor infrastructure, its development after this period has been significant. It now has a country wide, well-maintained, modern infrastructural network, which in quality is as good as that available in any developed country.

Table 4.12 shows Oman's performance in the development of infrastructure during the last twenty-five years. In order to overcome the bottlenecks and constraints that impede the functioning of a market economy and to achieve the various objectives of development strategy, notably the achievement of equitable distribution of the benefits of development among various regions of Oman, particular emphasis has been given to *infrastructure development in the successive five-year plans.*

Table 4.12
Indicators of infrastructure development

Indicators	Unit	1970	1975	1980	1985	1990	1995
Paved roads	Km.	10	708	2,157	3,701	4,893	6,213
Graded roads	Km.	2,168	5,495	14,703	18,280	18,686	24,276
International airports	Number	Nil	1	1	1	1	1
Electricity produced (annual)	Mn KW/H	8	154	818	2,498	4,504	6,500
Electricity connections	Number	1,000	12,622	52,693	157,214	241,122	335,074
Water production (annual)	Million gallons	156	359	2,458	6,364	11,624	16,755
Water connections	Number	456	5,020	16,645	31,546	69,448	88,100
Post offices	Number	2	27	41	63	71	90
Telephone connections	Number	557	3,701	15,044	41,320	107,409	177,655
Telephones per 1000 persons	Number	1	4	14	66	66	83

Sources: Compiled from Oman, *Statistical Year Book, 1985, 1990 and 1995* (Oman, 1986b; 1991b; and 1996b).

For example, annual production of electricity increased by 40 times, from 154 million kilowatt hour in 1975 to 6,500 million kilowatt hour in 1995. And during this period the number of electricity connections grew from 12,622 to 335,074, that is, almost 27 fold increase. Because high priority has been given to providing an adequate supply of fresh water as a basic necessity, the total annual supply of water grew by 45 times, from

359 million gallons in 1975 to 16,755 million gallons in 1995. The number of water connections rose from 5,020 in 1975 to 88,100 in 1995. The number of telephone lines grew by 48 times — from 3,701 in 1975 to 177,655 in 1995. As a result, the number of telephones per 1000 persons increased from only 4 in 1975 to 83 in 1995.

The above table also shows that in 1975 there were only 27 post offices whereas in 1995 this number had risen to 90. Paved roads in Oman extended to only 10 kms in 1970 and in 1975 this had increased to 708 kms; but by 1995, length of paved roads increased to 6,213 kms, so that almost the entire country has been covered by paved roads. In addition to paved roads, the country is serviced with a large network of graded roads that have increased from 5,495 kilometres in 1975 to 24,276 kilometres in 1995.

4.4.4 Equality

A central theme of Oman's development strategy has been to ensure that access to education and health is provided equally to male and female population within different regions of the country. Often the poor are unable to have access to such services; therefore, the state has to mobilise the necessary resources for human capital investments. This has been the case in Oman, as we shall see in Chapter V.

Female education is an essential element of any poverty reduction strategy. In Oman enrolment rates in education for females are fairly close to those for males. In terms of primary enrolment, female enrolment rate in 1993 was 82 per cent of the relevant age group and, for secondary education it was 57 per cent, and in 1988 about 96 per cent of females were completing grade 4 of basic education. For males, these figures were 87 per cent, 64 per cent and 97 per cent respectively (World Bank, 1996:p.201).

In terms of distribution of basic amenities, about 94 per cent of rural people had access to health services during 1985-95, compared to 100 per cent for the urban population (UNDP, 1996:p.152). Whilst in the initial five-year plans provision of electricity, water and roads, was concentrated in the main centres of population, the Fourth FYP, as we shall see in Chapter V, marked a policy shift towards regional distribution of amenities. According to the 1993 census, 74 per cent of the Omani population own the houses they live in and about 93 per cent of these houses have access to safe drinking water, while 86 per cent of these houses are connected to the public electricity network (Oman, 1993a:pp.223-229).

4.5 Factors Responsible for Oman' s Socio-Economic Development

Some of the factors responsible for the social and economic development of Oman have already been mentioned in this and previous chapters. These include the enabling factor of oil revenues, a necessary but not sufficient condition for ensuring the quantity as well as quality of development achieved. There is also the political will and commitment on the part of the state via the policies and planning for development which provide the complementary 'necessary' conditions for the pace and directions of development in Oman. These crucial elements are analysed in Chapters V and VI.

4.5.1 The state and development : a comparative note

It may be argued that the role of the state in Oman's development has not been as important as suggested by our research, but that the most significant factor in securing development in Oman has been a valuable natural resource, oil, which many other developing countries do not possess. Whilst it may be true that oil is a valuable resource, its price does fluctuate enormously in the same manner as those of other primary commodities such as rubber, tea, copper, etc. Hence good or bad policies and planning need to cope with this situation, or allow the situation to control the oil producing economy. Therefore, the policies, plans and institutional arrangements making good use of oil resources are as important as having the resource in the first place. Lack of appropriate state intervention through planning might well have taken Oman along a different path of development with different economic and social consequences[1]. A comparison with Trinidad and Tobago and Gabon, two countries somewhat comparable to Oman (small[2] oil exporting and open economies) in the area of economic and social development may be instructive.

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[1] As we shall see in Chapter V, the planning framework enabled Oman to overcome the problems caused by the collapse of oil prices in 1986 in a much more organised manner and with minimum of social and economic hardship.

[2] Small in terms of size of population.

Table 4.13

Trends in social and economic development : Oman compared with Trinidad and Tobago, and Gabon

	Oman	Trinidad and Tobago	Gabon
Estimated population (millions)[1]			
1960	0.6	0.8	0.5
1994	2.1	1.3	1.0
Annual population growth rate (%)[1]			
1960-94	2.7	1.2	2.3
Life expectancy at birth (years)[1]			
1960	40.1	63.3	40.8
1994	70.0	72.9	54.1
Infant mortality rate (per 1,000 live births)[1]			
1960	214	56	171
1994	28	15	91
Population with access to safe water (%)[1]			
1975-80	-	93	-
1990-96	82	97	68
One-year-olds fully immunised against[1]			
Tuberculosis (%) 1992-95	96	-	73
Measles (%) 1995	98	84	56
Gross enrolment ratio for all levels[1] **(% age 6-23 years)**			
1980	28	59	-
1994	60	67	-
Real GDP per capita (PPP$)[1]			
1960	2,040	4,754	1,373
1994	10,078	9,124	3,641
GNP per capita[2] **(average annual % growth) 1970-95**	**3.3**	**-0.1**	**2.8**
Growth of output[1] **(average annual % growth)**			
GDP 1980-90	8.3	-2.5	0.5
1990-95	6.0	1.0	-2.5
Agriculture:			
1980-90	7.9	-5.8	1.7
Industry:			
1980-90	10.3	-5.5	1.0
Manufacturing			
1980-90	20.6	-10.1	9.8
Services:			
1980-90	6.0	-3.3	-0.3

Table 4.13 contd...

Table 4.13 contd...

	Oman	Trinidad and Tobago	Gabon
Production of oil and gas[3] (million of tonnes)			
Oil 1983	19.6	8.2	7.8
1993	39.1	7.5	14.6
Gas[a] 1983	-[b]	2.7	-
1993	-[b]	5.6	-
Trade[2] (% of GDP)			
1970	93	84	88
1995	89	68	101
Present value of debt[2] (as % of GNP) 1995	**28.0**	**52.2**	**89.1**
Debt service as % of exports of goods and services[2]			
1980	6.4	6.8	17.7
1995	7.5	14.8	15.8
Net foreign direct investment [2](as % of GDP)			
1980	1.6	3.0	0.7
1995	1.2	5.6	-1.1
Terms of trade[2] (1987=100)			
1980	210	146	152
1995	77	86	90
Consumption[2] (as % of GDP) 1995			
Private	42	62	42
Public	31	13	10
Government current revenues[2] (as % of GDP)			
1980	38.2	42.5	35.5
1994	31.7	-	-
GDP implicit deflator[2] (average annual growth %)			
1980-95	-3.6	4.1	1.9
1990-95	-2.9	7.2	13.0

Note:

a) This is calculated in equivalent tonnes of crude oil.

b) Oman's gas production has been very small upto now and has been used mainly for domestic purposes.

Sources:

1) UNDP (1997) *Human Development Report 1997.*

2) World Bank (1997b) *World Development Indicators 1997.*

3) British Petroleum (1994) *Statistical Review of World Energy.*

Table 4.13 shows some areas in which Oman's policies and strategies have been rather more successful in securing development than those of Trinidad and Tobago and Gabon. Between 1960 and 1994 life expectancy at birth in Oman increased from 40.1 to 70 years; for Trinidad and Tobago and Gabon for the same years the figures are 63.3 and 72.9 and 40.8 and 54.1 years, respectively. This shows that life expectancy in Oman increased both absolutely, compared with Gabon, and relatively compared with Trinidad and Tobago. Infant mortality rate (per 1000 live births) decreased from 214 in 1960 to 28 in 1994; the figures for Trinidad and Tobago and Gabon are 56 and 15 and 171 and 91, respectively. Here again Oman's achievements have been relatively and absolutely better than Trinidad and Tobago and Gabon.

In the specifically economic aspects of development, the development of particular sectors of the economy reflect the crucial process of diversification and structural transformation of a country. Data in the *World Development Indicators* (1997b) show some interesting trends in sectoral development in the three countries. During 1980-90 output of agriculture in Oman grew at an average annual rate of 7.9 per cent; while during the same period it declined by an average annual rate of -5.8 per cent in Trinidad and Tobago and in Gabon the average annual growth rate was only 1.7 per cent during the same period. Growth of industry during 1980-90 reached an average of 10.3 per cent annually in Oman; whilst it declined on an average by 5.5 per cent annually in Trinidad and Tobago, and Gabon. In Gabon during the same period, industry grew at an annual average rate of 1.0 per cent. During 1980-90, the services sector in Oman grew at an average annual rate of 6.0 per cent whilst in Trinidad and Tobago it declined at an average annual rate of 3.3 per cent and in Gabon, it declined at an average annual rate of 0.3 per cent.

The differences in social development and the fluctuations in the economy (less in Oman, more in Trinidad and Tobago, and Gabon) cannot be simply accounted by fluctuations in the price of oil or volume of its output. The effects of these are mediated by state intervention — through policies and planning. And this is relatively more systematic in Oman than in Trinidad and Tobago and Gabon.

4.6 Conclusion

This chapter has described Oman's rapid progress in the spheres of education, health and provision of basic infrastructure as indicated by the marked improvement in primary school enrolment, female education, life expectancy, infant mortality and provision of paved roads, electricity, safe water and so on. Importantly, improvements in the economic and social conditions have proceeded relatively evenly without serious fluctuations in the pace and direction of economic development and its ramifications for social welfare. This is in spite of the fact that the price of oil and terms of trade have fluctuated mainly against Oman's favour. Of course, there are as yet no data on income distribution and levels of poverty in Oman. However, as we have shown the relatively easy access to economic infrastructures, education and health care, which are well developed in the country, preclude the possibility of the high incidence of poverty and social inequality that are found in some developing countries.

There is of course serious cause for concern and this relates to the fact that the Omani economy is crucially dependent on oil exports; the attempt at diversification has been less than successful and this is likely to create structural constraints in Oman's economy in the future.

Appendix table 4-AI

Trade orientation and real GNP per capita (average annual percentage growth)

	Outward oriented				**Inward oriented**			
Period	**Strongly**	%	**Moderately**	%	**Moderately**	%	**Strongly**	%
1963-73	Singapore	9.0	Brazil	5.5	Yugoslavia	4.9	Turkey	3.5
	South Korea	7.1	Israel	5.4	Mexico	4.3	Dominican Republic	3.4
	Hong Kong	6.0	Thailand	4.9	Nigeria	4.2	Burundi	3.2
			Indonesia	4.6	Tunisia	4.0	Argentina	3.1
			Costa Rica	4.6	Kenya	3.9	Pakistan	3.1
			Malaysia	3.8	Philippines	2.2	Tanzania	2.7
			Ivory Coast	3.5	Bolivia	2.0	Sri Lanka	2.3
			Colombia	3.3	Honduras	1.9	Ethiopia	1.9
			Guatemala	2.7	El Salvador	1.4	Chile	1.7
					Madagascar	1.1	Peru	1.5
					Nicaragua	1.1	Uruguay	1.5
							Zambia	1.2
							India	1.1
							Ghana	0.4
			Cameroon	-0.1	Senegal	-0.6	Bangladesh	-1.4
							Sudan	-1.9
Period	**Strongly**	%	**Moderately**	%	**Moderately**	%	**Strongly**	%
1973-85	Singapore	6.5	Malaysia	4.1	Cameroon	5.6	Bangladesh	2.0
	Hong Kong	6.3	Thailand	3.8	Indonesia	4.0	India	2.0
	South Korea	5.4	Tunisia	2.9	Sri Lanka	3.3	Burundi	1.2
			Brazil	1.5	Pakistan	3.1	Dominican Republic	0.5
			Turkey	1.4	Yugoslavia	2.7		
			Israel	0.4	Colombia	1.8		
			Uruguay	0.4	Mexico	1.3		
			Chile	0.1	Philippines	1.1		
					Kenya	0.3		
					Honduras	-0.1	Ethiopia	-0.4
					Senegal	-0.8	Sudan	-0.4
					Costa Rica	-1.0	Peru	-1.1
					Guatemala	-1.0	Tanzania	-1.6
					Ivory Coast	-1.2	Argentina	-2.0
					El Salvador	-3.5	Zambia	-2.3
					Nicaragua	-3.9	Nigeria	-2.5
							Bolivia	-3.1
							Ghana	-3.2
							Madagascar	-3.4

Source: World Bank (1987) *World Development Report 1987*, Washington, D. C.

Appendix table 4-AII

Production, reserves, exports and average price of oil (1967-96)

Year	Daily extraction (000 barrels)	Annual production (millions of barrels)	Reserves (millions of barrels)	Life of reserves (years)	Exports (in million barrels)	Average price ($/bbl)	Domestic use[a] (millions of barrels)	(% of annual production
1967	57	23	1,935	86	22	1.8	-	-
1968	241	88	1,832	21	88	1.8	-	-
1969	328	120	1,709	14	120	1.8	-	-
1970	332	121	1,455	12	121	1.8	-	-
1971	294	107	1,741	16	106	2.2	-	-
1972	282	103	1,669	16	103	2.5	-	-
1973	293	107	1,810	17	107	3.6	-	-
1974	290	106	1,638	15	106	12.3	-	-
1975	341	125	1,487	12	125	12.4	-	-
1976	367	134	1,280	10	134	12.5	-	-
1977	340	124	1,379	11	122	13.0	-	-
1978	314	115	1,514	13	116	13.1	-	-
1979	295	108	2,480	23	108	20.0	-	-
1980	283	104	2,484	24	102	36.9	-	-
1981	328	120	2,899	24	120	36.9	-	-
1982	336	123	2,982	24	119	34.4	2	1.6
1983	389	142	3,494	25	129	29.2	14	9.7
1984	416	152	3,844	25	135	28.0	16	10.7
1985	498	182	3,869	21	165	27.0	18	10.0
1986	560	204	4,015	20	187	13.5	19	9.5
1987	582	213	3,991	19	197	17.3	13	6.2
1988	619	227	4,144	18	212	13.5	16	6.9
1989	638	234	4,187	18	215	16.3	15	6.3
1990	684	250	4,161	17	229	20.7	17	6.9
1991	708	259	4,250	16	235	17.4	18	6.9
1992	742	270	4,349	16	253	18.0	14	5.3
1993	780	285	4,604	16	267	15.6	11	3.9
1994	810	296	4,828	16	271	15.2	18	6.2
1995	853	311	5,038	16	285	16.4	20	6.3
1996	883	323	5,112	16	296	19.4	15	4.6

Note:

a) Oman Oil Refinery started production in 1982.

Source: Compiled from internal data, Ministry of Development, Oman. With the exception of the data regarding reserves. all other data are available in the annual *Statistical Year Book* published by the Ministry.

CHAPTER V

DEVELOPMENT POLICY AND PLANNING IN OMAN'S DEVELOPMENT

5.1 Introduction

The lack of a diverse range of resources in Oman and the need to accelerate the process of development compelled the government in Oman to adopt development planning as a means to achieve a strategic allocation of resources among competing ends. Specifically the need for development planning arose because of the absence of basic economic and social infrastructure, poorly developed market mechanism, limited resources and risk-taking capacity of private entrepreneurs, weak linkages in the economy and untapped potential of large externalities of core industrial and infrastructural projects. The outcome of the strategic allocation of resources through development planning, that is economic and social development, has been described in the previous chapter. It is now necessary to analyse the means by which such economic and social development was secured. These means consist of two main parts: the management aspects which deal with managing the resources and maintaining stability of the economy; and the transformational aspects which deal with developing sectors which are weak or do not exist. Clearly both are necessary for securing development.

Oman launched its development planning process when the role of the state-led development strategies and the development theories supporting these was in disrepute[1]. This chapter analyses the reasons why policy makers in Oman considered it necessary to adopt planning, together with the planning machinery and other institutions that were set

[1] This was because of disenchantment with the results achieved in terms of reducing poverty, inequality and unemployment in a number of developing countries, as was discussed in Chapters I and II. This led to what might be termed as 'a crisis in planning' — As Seers (1972b:p.19) states: "the experience of the last decade suggests that we now need to think out again the purpose of planning and its procedures".

up to facilitate the process. After discussing briefly the process of plan formulation and implementation, an overview is provided of the growth of the economy and of gross fixed capital formation during 1976-95. We then analyse each five-year plan, its objectives, outcome and a brief assessment of its impact on the development process. The conclusion provides an overall assessment of these plans and the way development planning has been instrumental in both transforming the economy and society and managing the oil booms and the crises that followed.

5.2 Oman's Adoption of Development Planning

The necessity of planning as an instrument for promoting economic and social progress, on the basis of development experience of the pre-plan period of 1970-1975, is clearly brought out in the Development Council's February 1975 resolution on Oman's long-term development policy, which stated:

> Economic development policy during the past four years has achieved great success. Efforts have been concentrated during that period on meeting urgent requirements and on constructing infrastructure projects needed for increasing productivity and hence national income ... [H]aving laid down a suitable basis for the growth of a developing national economy, the country starts a new phase of economic development. There is obvious need for a comprehensive economic development plan ensuring the co-ordination between different investment projects and the carrying out of feasibility studies of projects before implementation. The plan should also give priority to income generating projects to supplement oil receipts. It should also effect a wider geographical distribution of investments in order that the benefits may be shared by different regions of the country. The plan should cover a reasonably long period of time, taking into account the

> economic conditions of the country and its future prospects. The more we succeed in formulating such a development plan and in rationalising the use of our present oil revenues, the more secure our economic future and our progress will be (Oman, 1976a:pp.106-107).

Between 1970 and 1975 economic development was effected in the form of projects incorporated in the annual state budget. However, because of the lack of an organised approach to development, a number of large scale civil and defence projects were initiated during 1974 and 1975 for which no budget allocations existed. This led to a series of large fiscal deficits[1] during 1974 and 1975 and an emerging financial crisis. A number of studies were initiated during 1974[2] and 1975 to help identify an appropriate course of development. Most notable of these studies was the one conducted by the World Bank in 1974 which recommended adoption of development planning as the most appropriate course of action (Townsend, 1977).

These studies prompted the setting up of the Development Council and the Financial Affairs Council in November 1974, and the enactment of the Economic Development Law of 1975 which provided the legal underpinning for development planning in Oman. During 1975, a number of tasks were carried out by the Development Council to prepare the First Five-Year Plan (First FYP). Among these were a detailed re-appraisal of all ongoing development projects, the preparation of the law relating to the organisation of Government administration, and the setting up of a number of committees[3] to study topics of importance for economic development (Oman, 1976a:pp.10-12).

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[1] For example, the 1974 deficit reached almost 10 per cent of GDP (Oman, 1976a:pp.4-7).

[2] These were: the *Report and Recommendations to the Executive Directors* of the World Bank, dated 15 February, 1974; the World Bank report *Current Economic Position and Prospects* of Oman, May, 1974; *Oman: Recent Economic Developments,* June, 1974, prepared by the IMF; and the report *Economic and Financial Position of Oman*, prepared in March, 1975 by a group of British banks led by Morgan Grenfell, London (Townsend, 1977 and Skeet, 1992).

[3] These included a committee for following up the implementation of Al Khaboura Region Projects, a committee for studying fuel problems in the Sultanate, a committee for following up the implementation of irrigation projects and the maintenance of falajs, and a committee for town planning and industrial zoning (*ibid.*).

5.3 The Planning Machinery : the Development Council

The kind of planning machinery a country establishes, like the kind of development planning it adopts, depends largely on its political, social and economic institutions and its stage of development (Waterston, 1982:p.371). Planning and development organisations in Oman have undergone several changes since 1970. In the absence of fully operational government executive units in the early 1970s, most of these organisations exercised both the planning and executive functions[1]. A clear break came with the establishment of the Development Council in November, 1974 to exercise planning functions. In the planning process, this was the most important first step, because of the important role a planning agency plays in shaping the development process and influencing its outcome. As Seers (1972b:p.33) argues, the role of the planning agency is to serve as "the nerve centre of the government machine, continually scanning experience and helping the government adjust its policies accordingly, in the light of a long-term strategy".

The Sultan has been the Chairman of the Development Council since its inception, while The Minister of State for Foreign Affairs — who in 1982 became the Deputy Prime Minister for Finance and Economic Affairs — has been its Deputy Chairman[2] (Oman, 1995c:Decree no. 43/82). The membership of the Council had been changed from time to time, however, at its dissolution in 1996, its members included the Chairman of Majlis Ash'Shura, and a number of senior government officials[3].

The Development Council was supported by a technical secretariat until 1994, when the Ministry of Development was formed. Most of the functions relating to planning and development of the technical secretariat were transferred to the Ministry and the

[1] Oman's First FYP (Oman, 1976a:p.9) gives a detailed account of the organisations involved in planning. Chapter IV of this thesis also gives brief details of the evolution of the planning institutions.

[2] With the death of the Deputy Chairman in September 1995, the Development Council was dissolved in January, 1996, and its responsibilities were transferred to the Cabinet (Oman, 1996g).

[3] These were Ministers of: National Heritage and Culture, Petroleum and Minerals, Adviser to His Majesty for Economic Planning Affairs, Communications, Electricity and Water, Agriculture and Fisheries, Housing, Health, Regional Municipalities and Environment, Commerce and Industry, Social Affairs and Labour, Education, Development Affairs, and Secretary to the Cabinet. Other members were the Undersecretary for Finance in the Ministry of Finance and Economic Affairs, the Economic Adviser to the Ministry of Diwan, and the Secretary General of the Development Council, (Oman, 1995c):Decree no. 29/81; Decree no: 29/92).

Secretariat's functions were confined to co-ordination and secretarial services for the Council (Oman, 1995c:Decree no. 2/94 and 19/94).

The Sultan's Chairmanship of the Council ensured, on the one hand, that it was fully attuned to current government policy, which provided the framework within which plans were prepared, while on the other, it provided the Council with the political weight needed to co-ordinate and direct the activities of different agencies of government. This has a few similarities with the importance given to the planning agency in India. To quote Mazoomdar:

> When planning was first undertaken in India, the decision to have the Prime Minister as the Chairman of the Planning Commission had both a personal and an institutional significance. Jawaharlal Nehru was clear in his perception that development must be the primary goal of national policy after independence had been achieved, and that planning was the key to development; he lent his whole weight to this endeavour (Mazoomdar, 1994:p.82).

However, an important difference between Oman's Development Council and India's Planning Commission is that the members of the latter body are independent (non-government) public figures or experts and the Prime Minister, as the ex-officio chairperson, is only the nominal head. The executive chief of Indian Planning Commission is the Deputy Chairman who is not a member of the Government. In contrast, most of the members of Oman's Development Council are executives of the Government.

Under the Economic Development Law of 1975, the period of each plan was set at five years, with the first development plan covering the period 1976-80. Under Oman's planning system, the Development Council is responsible for setting long-term goals and objectives of development and formulating the five-year plans; the Financial Affairs

Council[1] is responsible for short-term and medium-term fiscal policies, with the Ministry of Finance and Economy[2] being responsible for raising the resources for public expenditure (current and capital) and expenditure control; and the Central Bank of Oman is in charge of monetary policy.

The annual state budget provides the fiscal linkages between the economic rents generated from oil and the rest of the economy. It also acts as an instrument for linking short-term fiscal management with the medium — and long-term objectives articulated within the five-year plans.

An important element of Oman's planning system is that formulation and implementation of five-year plans is closely co-ordinated with the medium — and short-term economic and fiscal policies because the Sultan was the head of the Development Council and the Financial Affairs Council and the Deputy Prime Minister for Finance and Economic Affairs[3] was the Deputy Chairman of these councils. This factor has, on the one hand, contributed significantly to the successful implementation of public investment programmes laid down in successive development plans. On the other hand, one can argue that the continuing over-runs in current public expenditure and the addition of several unplanned projects to the Second Plan, were the consequences of this close relationship between the Development Council and the Ministry of Finance and Economy.

5.4 Other Institutions Facilitating Development Planning

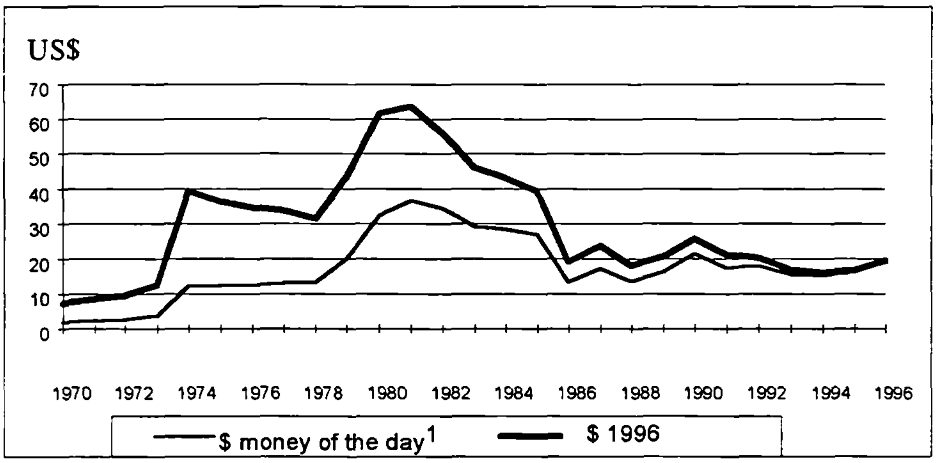
In Chapter II, we discussed the importance of selecting appropriate strategies and policies for managing the revenues accruing from the export of a primary resource. Equally important is the management of the cyclical fluctuations in the export price of commodities. This is even more crucial for oil exporting countries like Oman which have comprehensive development programmes over long periods of time. Without effective

[1] Now the Financial Affairs and Energy council with its scope broadened to include energy affairs. The Sultan continues to be its chairman and the Minister of Economy, who also supervises the Ministry of Finance acts as its Deputy Chairman (Oman, 1996i:Decree no. 60/96).
[2] Now the Ministry of Finance (Oman, 1995d:Decree no. 69/95).
[3] The Deputy Prime Minister for Finance and Economic Affairs was also in charge of the Ministry of Finance and Economy (Oman, 1995c:Decree no. 13/82).

management, the great volatility that has characterised oil prices since the late 1970s, can have a deleterious impact on the funding of these economic and social programmes. Chart 5.1 illustrates the fluctuation and volatility in the price of oil in Oman.

Chart 5.1

Omani oil price volatility (1970-96) US$ per barrel



Note:
1) $ money of the day is the market price in a particular year while $ 1996 is the price of that particular year calculated in 1996 dollars.

Source: Data provided by Petroleum Development of Oman Ltd.

Specifically the volatility may result from the Dutch disease whose effects we described in Chapter II. This is characterised by a cyclical resource boom including, *inter alia*, inflation, currency appreciation in real terms, and spending ahead of implementation capacity. The downswing poses equally serious problems. Decline in prices of primary produce lead to decreases in government revenue, which, in turn, lead to reductions in both development and recurring expenditure[1]. Therefore, policies initiated to manage the fluctuations in primary exports are crucial for managing the development process in a country like Oman.

[1] In addition to the negative consequences of the reduction in public expenditure on the economy, to the extent that the mining industry is integrated with the domestic economy, serious reduction in primary export prices would lead to widespread unemployment and/or reduction in real wages (Lewis Jr., 1989:pp.1562-64).

The impact of the Dutch disease on diversification in Oman will be discussed in Chapter VII. Here we need to discuss briefly the policies and mechanism adopted by the government of Oman to manage the volatility in oil prices especially from 1980 onwards, when the price of oil recorded a sharp increase during 1979-1981[1], and a sharp decline during 1982-86.

5.4.1 Establishment of the State General Reserve Fund (SGRF)

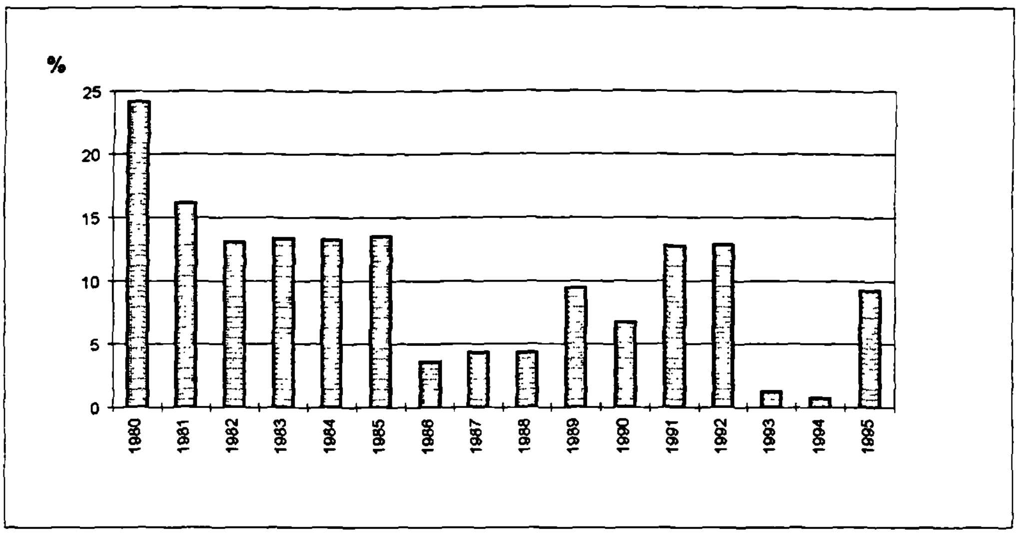
The establishment of the SGRF marked an important phase in establishing the institutions of the management aspect of Oman's development. This was established in the wake of the second oil price increase[2] in 1979 and 1980, when the government decided in 1980 to put a part of the additional revenues into a reserve, known as the State General Reserve Fund. It was established by Royal Decree no. 1/80 issued on 6 January, 1980 (Oman, 1981a:pp.243-246). Article Eight of the decree stipulated that 15 per cent of each sum received from oil revenues should be transferred to the Fund. In addition, all income from the investments of the SGRF assets was to be reinvested in the Fund. Article Six stipulated that there should be no withdrawals from the SGRF except for the purpose of financing a deficit in the state budget in the years which may require such withdrawals. Chart 5.2 below indicates the percentage of gross oil revenues that have been transferred into the SGRF from 1980 onwards.

[1] As Appendix table 4-AII shows, the average oil price per barrel increased from US$ 20 in 1979 to about US$ 37 between 1981 and 1982. While during 1983-86, the average price varied between US$ 29 and US$ 13.5.

[2] The increased oil revenues from the first oil price increase from US$ 4 per barrel in 1974 to US$ 12 per barrel in 1979 (cf. Appendix table 4-AII) were added to the government accounts, giving a much needed boost to an economy just emerging from a state of long stagnation. In addition, larger funds had to be allocated for the purpose of defence and national security, since the government was fighting an insurgency in southern Oman.

Chart 5.2

Percentage of gross oil revenues transferred to the SGRF (1980-95)



Source: Oman, Ministry of Development internal data.

The proportion of gross oil revenues transferred to the SGRF followed the trend of oil prices and oil revenues accruing to the government. Transfers into the SGRF reached almost 25 per cent in 1980, when the average price of oil increased to US$ 36.9 from US$ 20 per barrel, but these transfers declined in the mid-eighties and plunged to 3.6 per cent in 1986 when the average oil price collapsed to an average of US$ 13.5 per barrel.

The government's objective in setting up the SGRF was two-fold. The first was to provide a source of income for the future, to be used to finance the state budget in the years which might require such withdrawals, in other words, to provide a mechanism for mitigating the difficulties brought by downswings in the oil price. The second objective was to minimise the adverse effects of the Dutch disease in a period of upswing. As we shall see later in this chapter, the existence of such a fund has greatly facilitated the development process and has enabled Oman to adjust to the falling oil prices in the 1980s in a more planned manner. There were other relatively minor reserve funds set up which supplemented the SGRF, such as the Contingency Reserve Fund and the Petroleum Reserve Fund, which we need not discuss at length.

5.5 Formulation and Implementation of the Five-Year Plans

The role of the government in the socio-economic development of Oman and the government's economic, social, fiscal and monetary policies have been crystallised through the formulation and implementation of development plans since 1976. Four five-year plans have been completed and the Fifth FYP (1996-2000) is under implementation. These plans, as we noted in Chapter III, have generally articulated the medium-term objectives and targets to be achieved within the framework of the basic objectives of Oman's long-term development strategy adopted by the Development Council in 1975[1].

Oman's long-term development strategy and objectives[2] indicate that it has benefited from some of the criticisms of state-led development planning adopted by many LDCs by shedding the negative aspects associated with that strategy. As stated in Chapters I, II and III, development planning was criticised in the 1970s because of its failure to address directly issues relating to social (human) development, inequality and the role of the market. In view of this criticism, Oman's long-term strategy was much wider in its scope and less regulatory in its intent. In other words, at the outset Oman incorporated into its development planning those features whose neglect by other developing countries had created problems of increased inequality, poverty and stifling of entrepreneurial initiative. This is clearly brought about by three crucial aspects of this strategy (Oman, 1976a:pp.107-108).

First, on human development, Para 6 of this strategy emphasised that: "Care should be taken to develop the local human resources in order that they may be able to play a more active role in the national economy".

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[1] The text of Development Council's resolution (dated February 9, 1975) on aims and objectives of Oman's long-term development strategy is given in Appendix C of the *Five-Year Development Plan (1976-80)* (Oman, 1976a).

[2] These are: (i) to ensure sustained improvement in people's physical quality of life; (ii) to reduce the dependence upon oil exports by expanding and diversifying the non-oil sector; (iii) to develop a country wide network of modern economic infrastructure; (iv) to develop human resources through investment in social infrastructure; (v) to promote balanced regional development; (vi) to sustain a free market and competitive economy; and (vii) to allow free trade in goods, services, capital and technology with minimum restrictions (Oman, 1976a).

Secondly, in relation to equitable distribution of the benefits of development, Para 5 of the strategy stated: "It is necessary to effect a wider geographical distribution of investments in order that the benefits may be shared by different regions to the greatest possible extent and to narrow the gap in the standards of living in different regions ..."

Thirdly, to ensure that planning did not suppress private enterprise and restrict competition, Para 4 and 12 of the long-term strategy emphasised the complementary roles of the state and private sector in the development process. "The basis of our development policy should be to achieve the basic requirements of a free economy in which an efficient and capable private sector plays a leading role" (*ibid.*:p.107).

Of course, statements similar to this may be found in similar resolutions and documents of intent in other countries. It is one thing to make policy statements and quite another to put these into practice. In Oman, as compared to other countries, the gap between theory and practice, between public statement and real intent has been extremely narrow. In contrast this gap has been rather wide, for example, in Pakistan or its next-door neighbour India (Chakravarty, 1987:Chapters 3 and 4). Such broadening of the scope of development planning has given Omani planning the balance and flexibility absent in other countries and also removed the paranoia so notably prevalent among the private sector in those countries.

While the basic framework of all the five-year plans was established within the context of the Development Council's 1975 Resolution, the medium-term objectives of each five-year plan were decided on the basis of the economic, social, financial and even the political situation prevailing at the time of the preparation of the concerned five-year plan[1].

[1] For instance, establishing the State General Reserve Fund in the wake of the second oil price increase was one of the main objectives of the Second FYP (Oman, 1981a:p.32).

5.5.1 Implementation of the five-year plans

Implementation of the plan is a crucial element of the complex totality referred to as planning practice. This has been discussed in sections 3.4 and 3.5 of Chapter III. The significance of implementation of plans lies in the fact that without proper operationalisation or implementation, plans remain mere documents of intent. According to Waterston (1982) the implementation of plans is often the Achilles heel of planning in the developing countries. While good policies and plans need sound and efficient implementation, this task can be rather difficult because there are a large number of factors that affect the implementation of plans.

There are two distinct but related aspects to implementation. Firstly there is the machinery or institutional arrangements for implementation. This consists of various ministries, departments and sections of departments, as well as *ad hoc* bodies set up to execute plans at different stages of their implementation. Quality of personnel, degree of integration and co-ordination between implementing bodies determine the quality and efficiency of implementation. This is the relatively static aspect of implementation.

The second aspect of implementation consists of relatively more dynamic processes. This involves allocation and re-allocation of resources between patterns of investment, production and consumption, re-arrangements of sectoral priorities, and so on. This dynamic or processual aspect is affected by changing and unpredictable domestic and/or international conditions such as increase or fall in revenues resulting from a rise or down-turn in the terms of trade; change of policy; political situation, and environmental or ecological factors and drought, floods, etc. These may affect the targets and the sectoral balance or priorities of the plans. Some of these factors have affected the implementation of planning in Oman.

In Oman, the Development Council[1] is responsible for formulation of the plans in co-ordination with other government ministries and departments, while implementation is

[1] Although the Development Council was dissolved in 1995, its functions will continue to be exercised by the Cabinet as has been the case in the past. Therefore, all references to the Development Council and its

the responsibility of individual ministries and departments. However, the Development Council is responsible for co-ordinating between implementing bodies, in addition to monitoring and evaluating the outcome on a regular basis[1].

It is necessary to provide an overview of the growth of the economy and capital formation over the last two decades of development planning before we discuss each plan individually.

5.6 An Overview of the Growth of the Economy and of Gross Fixed Capital Formation : 1976-1995

Since we have provided a detailed analyses of the leading economic and social development indicators in Chapter IV, we will limit our review to providing a comparison of the targets set in each five-year plan and their outcome. This will comprise the growth of the economy and its structure of production and demand. Moreover, since socio-economic development is a function, among other things, of the rate of capital formation, it is important to analyse the sectoral distribution of public and private investments and the level of capital formation that was undertaken during the four five-year plans, i.e. 1976-95. The plan-wise data relating to the growth and structure of production are given in table 5.1, whilst table 5.2 provides an overview of the changing structure of the demand in the economy. Tables 5.3 and 5.4 show sectoral distribution of both public and private investment[2].

5.6.1 Growth of the economy : planning in uncertainty

Planning is needed especially in situations of uncertainty. And uncertainty has characterised the achievement of targets under planning in Oman. Thus targets and actual

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functions, also refer the Cabinet. The Ministry of Development continues to provide the technical input to the planning process. That is recommending goals, objectives and policies for socio-economic development, plan monitoring and evaluation.

[1] This is being done through brief quarterly follow-up reports and a detailed annual report (Oman, 1996a:pp.548-549).

[2] The terms investment and capital formation and gross fixed capital formation (GFCF) are used interchangeably in this chapter.

outcomes of five-year plans have differed sometimes considerably. For example the actual average growth[1] rate of 23 per cent in the First FYP and of 3.4 per cent in the Third FYP turned out to be much higher than the planned growth rates of 2.2 per cent and -2.4 per cent respectively. In contrast, for the Second FYP and Fourth FYP the actual growth rates of 10.9 per cent and 2.8 per cent were much below the targets of 13.1 per cent and 6.3 per cent respectively.

As table 5.1 indicates the main reason for the divergence between planned and actual growth rates is the volatility of the oil prices, as reflected in the activities of the petroleum sector, where the impact of the volatility is felt most. While planning can protect the non-oil sectors against fluctuations in the oil market through the adjustment mechanism (SGRF), it has little influence on events taking place at the international level which affect the value-added in the petroleum sector and through it the external sector. In other words planning can mitigate, deflect and cushion shocks. As we shall see later, planning did succeed in raising actual level of oil production above the targeted levels, but the average annual growth rates realised in the petroleum sector declined continuously and steeply over successive plans; from 21.3 per cent in the First FYP, they fell to 5.5 per cent in the Second FYP, then to 4.2 per cent in the Third FYP, and in the Fourth FYP petroleum activities shrank at an average annual rate of 2.8 per cent.

The success of the planning in gradually reducing Oman's dependence on the oil sector is reflected in the high annual growth rates achieved by the non-petroleum activities in all the plans except the Third FYP[2]. More importantly, in all the four five-year plans, the actual growth rates realised by the non-petroleum activities exceeded the planned growth rates (cf. table 5.1).

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[1] The analysis of the growth rates of the GDP carried out in this chapter might differ slightly from that in Chapter IV, since, to facilitate comparison of the outcome with targets set in each successive plan, GDP estimates based on old SNA methodology have been used in this chapter, because the targets in each plan have been based similarly on the old methodology.

[2] In the First, Second and Fourth FYPs the non-oil sector's GDP grew at the rates of 27 per cent, 18 per cent and 7 per cent respectively compared to the plan targets of 8 per cent, 13 per cent and 7.3 per cent respectively. In the Third FYP its growth rate was 2.7 per cent compared to plan target of 0.7 per cent (cf. table 5.1).

Achievement of high growth rates in the non-petroleum activities has been a central tenet of the development policy to diversify the economy. The result of this policy is shown in table 5.1. This indicates that while value-added in the petroleum activities contributed 58.5 per cent of total output in the first year of the First FYP (1976), its contribution in the last year of the Fourth FYP had declined to 38.0 per cent. Thus the outcome of the policies initiated within the four five-year plans, was that the value-added in the non-petroleum activities of manufacturing, construction, agriculture and fisheries, and services increased from 41.5 per cent in 1976 to 62.0 per cent in 1995.

However, this desirable process has been offset by the premature expansion in the services sectors. As table 5.1 indicates, while the relative share of value-added in the services sector has grown substantially from 28.2 per cent in 1976 to 47.3 per cent in 1995, the value-added in manufacturing and non-oil industrial activities and agriculture and fisheries has increased only marginally from 13.3 per cent to 14.7 per cent during the same period. This phenomenon is an outcome of a large increase in public expenditure which has made investment in services more profitable and a liberal trade policy which has deprived the real sectors[1] of the economy from needed protection.

[1] *These are the manufacturing, agriculture and fisheries sectors.*

Table 5.1

Growth and structure of the economy : production[a] plan compared with actual (1976-95) at current prices

Item		First Plan	Second Plan	Third Plan	Fourth Plan
Growth of the economy: production					
(Average annual growth rate %)					
Nominal GDP at market prices					
Plan		2.2	13.1	-2.4	6.3
Actual		23.3	10.9	3.4	2.8
Petroleum sector- oil and gas					
Plan		-1.3	13.0	-6.3	5.0
Actual		21.3	5.5	4.2	-2.8
Non-petroleum activities					
Plan		8.1	13.4	0.7	7.3
Actual		27.0	17.8	2.7	7.4
Manufacturing					
Plan		64.1	34.2	15.2	12.7
Actual		49.3	39.5	12.9	11.8
Other industrial activities[b]					
Plan		-2.2	12.5	-6.8	12.1
Actual		13.2	16.4	-8.0	6.0
Agriculture and fisheries					
Plan		8.2	15.6	3.3	7.6
Actual		21.1	12.2	6.3	5.9
Services[c]					
Plan		10.1	12.2	0.2	6.0
Actual		32.5	17.7	3.5	7.2
Public[d]					
Plan		13.5	11.0	0.1	3.5
Actual		29.7	19.7	6.6	4.4
Private					
Plan		7.9	13.1	0.3	7.7
Actual		34.0	16.7	1.6	9.1
Memo: Industry[e]					
Plan		-0.6	13.3	-4.6	6.4
Actual		20.6	7.4	3.2	0.8

Table 5.1 contd...

Table 5.1 contd...

Structure of production	1976	1980	1985	1990	1995
Nominal GDP (RO Million)					
Plan	758	806	3,375	3,059	4,777
Actual	884	2,063	3,454	4,084	4,679
Distribution of GDP (%)					
Petroleum activities - value-added					
Plan	66.6	56.5	67.6	38.8	42.3
Actual	58.5	62.0	48.5	50.3	38.0
Non-petroleum activities - value-added					
Plan	33.4	43.5	32.4	61.2	57.7
Actual	41.5	38.0	51.5	49.7	62.0
Manufacturing					
Plan	0.4	3.1	2.3	7.4	5.8
Actual	0.5	0.8	2.4	3.7	5.7
Other industrial activities[b]					
Plan	10.7	8.1	6.6	6.7	7.2
Actual	10.7	6.5	8.3	4.6	5.4
Agriculture and fisheries					
Plan	2.4	3.7	2.2	3.7	3.8
Actual	2.1	2.5	2.7	3.1	3.6
Services[c]					
Plan	19.9	28.7	21.3	43.5	41.0
Actual	28.2	28.2	38.1	38.2	47.3
Public[d]					
Plan	8.0	12.4	9.4	15.7	15.5
Actual	7.8	9.4	13.8	16.1	17.4
Private[c]					
Plan	11.9	16.3	11.9	27.8	25.5
Actual	20.4	18.7	24.2	22.2	29.9
Memo: Industry[e] - value-added					
Plan	77.7	67.6	76.5	52.9	55.3
Actual	69.7	69.3	59.2	58.6	49.1

Notes:

a) Data based on GDP estimates on old national accounts methodology. Although the Ministry of Development has changed the GDP estimates from 1993 onwards to SNA 1993, we have used only the old estimates to facilitate comparison with planned estimates, which are based on old SNA methodology.
b) Include mining, quarrying, electricity and water, and construction.
c) Imputed financial charges and import taxes have been adjusted from this item.
d) Represents producers of government services.
e) Industry includes petroleum activities, manufacturing and other industrial activities.

Sources: Data for Oman compiled from Oman (1976a; 1981a; 1986a and 1991a). Data for actuals from 1) Oman (1986b:pp.395-404); 2) Oman (1988 and 1991b:pp.375-388) and 3) Data provided by the Omani Ministry of Development.

The structure of demand in the economy[1], reflects the large increase in the government's current expenditure[2], so that the share of public consumption grew from 27.2 per cent of GDP in 1976 to 33.1 per cent of GDP in 1995, whereas the plan target for the latter year was only 25.0 per cent. As we shall see later, from the time of the unplanned expansion of public expenditure in the Second FYP, the government's efforts to control the growth of public current expenditure, and hence public consumption have been largely unsuccessful.

As a result the level of gross domestic savings has declined from 52.2 per cent of GDP in 1976 to 25.9 per cent in 1995 whereas the target for 1995 was 32.6 per cent (cf. table 5.2). This reflects the growing dependence of the economy on purchase of goods and services from abroad and the large increase in production of non-traded services compared to the production of physical tradable commodities. As a result, the level of gross national savings has declined from 35.5 per cent of GDP in 1976 to 8.8 per cent in 1995, whereas the target set for that year was 20.3 per cent.

The decline in national savings ratio is also reflected in the deterioration of the current account of balance of payments. Table 5.2 shows that in 1995, the small planned deficit of RO 9 million had grown to RO 342 million, representing 7.3 per cent of GDP for that year. The steep decline in the ratio of national savings to GDP has also caused significant decrease in gross fixed capital formation which, as a percentage of GDP fell from 36 per cent in 1976 to 16 per cent in 1995, much below the Fourth FYP target of 20.5 per cent for 1995.

[1] Sometimes referred to as "expenditure on GDP".

[2] This point is discussed later, particularly in section 5.10.2 (on implementation of Fourth FYP).

Table 5.2

Structure of the economy : demand[a]

plan compared with actual (1976-95) at current prices

Item	1976	1980	1985	1990	1995
Nominal GDP (RO Mn.)					
Plan	758	806	3,375	3.059	4,777
Actual	884	2,064	3,456	4,084	4,679
Distribution of GDP					
Final consumption (RO Mn.)					
Plan	411	426	1,532	2,381	3,218
Actual	422	1,076	2,066	2,698	3,469
Relative share of GDP (%)					
Plan	54.2	52.9	45.4	77.9	67.4
Actual	47.8	52.1	59.8	66.1	74.1
Public (%)					
Plan	41.6	39.2	28.1	28.3	25.0
Actual	27.2	24.1	25.9	28.5	33.1
Private (%)					
Plan	12.6	13.7	17.3	49.6	42.4
Actual	20.6	28.0	33.9	37.6	41.0
Gross domestic saving (GDS) (RO Mn.)					
Plan	347	380	1,843	678	1,559
Actual	462	988	1,390	1,386	1,210
Relative share of GDP (%)					
Plan	45.8	47.1	54.6	22.1	32.6
Actual	52.2	47.9	40.2	33.9	25.9
Public (%)					
Plan	-	11.9	8.1	10.4	14.8
Actual	-	25.3	15.9	11.4	3.6
Private (%)					
Plan	-	35.2	46.6	11.7	17.9
Actual	-	22.6	24.3	22.5	22.3
Less: Factor income and transfers (RO Mn.)					
Plan	-135	-102	-	-	-587
Actual	-148	-212	-399	-417	-800

Table 5.2 contd...

Table 5.2 contd...

Item	1976	1980	1985	1990	1995
Gross national saving (GNS) RO Mn.					
Plan	212	278	-	-	972
Actual	314	776	991	969	410
Relative share of GDP (%)					
Plan	28.0	34.5	-	-	20.3
Actual	35.5	37.6	28.7	23.7	8.8
Public					
Plan	-	11.9	-	-	14.8
Actual	-	25.3	15.9	11.4	3.6
Private					
Plan	-	22.6	-	-	5.5
Actual	-	12.3	12.8	12.3	5.2
Gross fixed capital formation (GFCF) (RO Mn.)					
Plan	314	201	863	527	981
Actual	317	466	953	508	752
Relative share of GDP (%)					
Plan	41.4	24.9	25.6	17.2	20.5
Actual	35.9	22.6	27.6	12.4	16.1
Public					
Plan	33.8	13.2	16.4	11.6	13.5
Actual	29.4	14.8	20.3	7.5	11.1
Private					
Plan	7.7	11.8	9.2	5.6	7.0
Actual	6.5	7.8	7.3	4.9	5.0
Saving surplus (+) or gap (-) (GNS-GFCF) RO Mn.					
Plan	-102	+77	-	-	-9
Actual	-3	+310	+38	+461	-342

Note:

a) Data based on the old SNA methodology, and not SNA 1993 methodology, to facilitate comparison with plan estimates which are all based on the old SNA methodology.

Sources: Data for plan figures complied from Oman (1976a; 1981a; 1986a; 1991a).

Data for actual figures compiled from: 1976, 1980 and 1985 (Oman, 1986b:pp.429-434); 1990 (Oman, 1991b:pp.407-411); and 1995 (Oman 1996b:pp.428-431).

5.6.2 Gross fixed capital formation (GFCF) : sectoral distribution and public-private shares

Table 5.3 provides a breakdown of public and private gross fixed capital formation implemented during the period 1976-95. As the table indicates, the combined public and private capital formation, which in the First FYP period, was RO 1,682 million, i.e. more than doubled during the period to reach RO 3,857 million in the Fourth FYP period. Between these two periods, private sector investment grew by 171 per cent, from RO 495 million in the First FYP to RO 1,344 million in the Fourth FYP while public sector investment increased during the period by only 111 per cent, from RO 1,187 million to RO 2,513 million respectively. Moreover, as the private sector expanded, its share in GFCF increased from about 29 per cent in the First FYP to about 35 per cent in the Fourth FYP whereas the share of public investment declined from around 71 per cent to 65 per cent during this period.

Comparing the actual level of public investment with the plan, it is very clear from table 5.3 that the outcome is indeed very impressive. The overall cumulative level of implementation was almost 100 per cent over the period of the four plans. In the goods producing sector it was about 91 per cent, whereas, in the infrastructure sector it was 107.6 per cent. And although the targets set in the plan for the private sector are indicative, the cumulative level of implementation — ratio of actual to plan — of 96.9 per cent clearly suggests that planning in Oman has been successful in promoting private sector development and 'crowding in' private investment.

Table 5.3

Public and private gross fixed capital formation (GFCF) by main sectors (1976-95) plan compared with actual

P = Planned, A = Actual, I = Implementation (ratio of actual to plan)

(Amount in RO Million)

Sector	First Plan (1976-80)	Second Plan (1981-1985)	Third Plan (1986-90)	Fourth Plan (1991-1995)	Cumulative of Four Plans (1976-1995)
Public GFCF					
Plan	**935**	**1,961[a]**	**2,277**	**2,778**	**7,951**
Actual	**1,187**	**2,165[b]**	**2,065**	**2,513**	**7,930**
Implementation (%)	**126.9**	**110.4**	**90.7**	**90.5**	**99.7**
Goods producing					
Plan	235	790	727	1,121	2,873
Actual	267	680	677	975	2,599
Implementation (%)	113.4	86.1	93.1	87.0	90.5
Services					
Plan	193	456	485	470	1,604
Actual	190	549	385	469	1,593
Implementation (%)	98.2	120.4	79.6	99.7	99.3
Infrastructure					
Plan	507	715	1,065	1,187	3,474
Actual	730	936	1,003	1,069	3,738
Implementation (%)	144.1	130.9	94.1	90.1	107.6
Relative share of total (GFCF %)					
Plan	69.0	62.7	69.1	67.8	67.0
Actual	70.6	65.6	71.5	65.1	67.6
Private GFCF					
Plan	**420**	**1,168**	**1,017**	**1,319**	**3,924**
Actual	**495**	**1,137**	**825**	**1,344**	**3,801**
Implementation (%)	**117.8**	**97.3**	**81.1**	**101.9**	**96.9**
Goods producing					
Plan	255	853	748	947	2,803
Actual	284	770	602	822	2478
Implementation (%)	111.5	90.3	80.5	86.8	88.4
Services					
Plan	165	315	269	353	1,102
Actual	211	367	223	522	1,323
Implementation (%)	127.7	116.5	82.9	148.0	120.0
Infrastructure					
Plan	-	-	-	19	19
Actual	-	-	-	-	-
Implementation (%)	-	-	-	-	-
Relative share of total (GFCF %)					
Plan	31.0	37.3	30.9	32.2	33.0
Actual	29.4	34.4	28.5	34.9	32.4

Table 5.3 contd...

Table 5.3 contd...

Sector	First Plan (1976-80)	Second Plan (1981-1985)	Third Plan (1986-90)	Fourth Plan (1991-1995)	Cumulative of Four Plans (1976-1995)
Total GFCF					
Plan	**1,355**	**3,129**	**3,294**	**4,097**	**11,875**
Actual	**1,682**	**3,302**	**2,890**	**3,857**	**11,731**
Implementation (%)	**124.1**	**105.5**	**87.7**	**94.2**	**98.8**
Goods producing					
Plan	490	1,643	1,475	2,068	5,676
Actual	551	1,450	1,279	1,797	5,077
Implementation (%)	112.4	88.3	86.7	86.9	89.4
Services					
Plan	358	771	754	823	2,706
Actual	401	916	608	991	2,916
Implementation (%)	111.8	118.8	80.7	120.4	107.8
Infrastructure					
Plan	507	715	1,065	1,206	3,493
Actual	730	936	1,003	1,069	3,738
Implementation (%)	144.1	130.9	94.2	88.6	107.0

Notes:

a) This figure does not include RO 135 million allocated for the private sector as loans and grants and RO 59 allocated to finance the specialised banks both included in the Second FYP under Development expenditure (Oman, 1996a:p.23), since actual expenditure has been treated as financial investments and hence excluded from GFCF.

b) Exclusive of RO 591 million expenditure on defence and national security for civil purposes (*ibid.*).

c) Total public GFCF will not reconcile with total development expenditure shown in table 5.5 and elsewhere within government accounts, because GFCF also includes investment expenditure of self-financing SOEs and capital expenditure incurred by defence and national security units which is included under First, Third, and Fourth plans, but excluded from Second Plan because it was not originally included in the plan.

Sources: Data for Plan figures compiled from: First plan (Oman, 1976a:p.25); Second Plan (Oman, 1986a:pp.22-23 and 30-31); Third and Fourth Plan (Oman, 1991a:p.178);
Data for Actual figures compiled from: First Plan (Oman, 1986a:p.19); Second Plan (Oman, 1986a:pp.22-23 and 30-31); Third and Fourth Plan (Oman, 1996b:pp.430-431) and based on SNA 1993, with detailed sectoral breakdown obtained from the Omani Ministry of Development data.

In Chapter II, we stressed the importance of the sectoral distribution of capital formation as one of the main instruments through which the state can promote structural transformation. Therefore, (as Appendix tables 5-AI and 5-AII detail) the pattern of sectoral distribution of investment has changed from one plan to another in line with the changing priorities and dynamics of the development process. However, the aggregate sectoral allocation of government investment does not reflect the developmental priorities of the five-year plans because the capital intensity varies greatly from one sector to another. For instance, health, education, agriculture, fisheries, etc. are sectors with relatively low capital intensity whereas oil and gas have very high capital intensity. As we saw in Chapter IV, both health and education were given high priority, and the results were commensurate with these priorities although the proportion of government investment allocated to these sectors was relatively small.

Table 5.4 below shows that under the four five-year plans completed during the period 1976-95, the cumulative total of actual investment amounted to RO 11.7 billion of which about 35 per cent was invested in production of oil and gas, 8 per cent was invested in (non-oil) mining, agriculture, fisheries and manufacturing and 25 per cent in provision of services like public utilities, housing, trade and tourism, communication, finance and transport. A relatively large proportion, about 32 per cent was invested in building the networks of economic infrastructure (roads, ports, etc.) and social infrastructure (education and health) and this infrastructural investment was funded almost entirely by the government[1].

Private investment was mainly in oil and housing and manufacturing. Out of the total private investment of RO 3.8 billion undertaken during the period 1976 to 1995, 50 per cent was invested in oil, 27 per cent in housing, 13 per cent in agriculture, fisheries and manufacturing and 8 per cent in trade, tourism, financial institutions and transport.

Out of a total of public investment of RO 7.9 billion, undertaken during 1976-1995, 28 per cent was invested in oil and gas, 4 per cent in agriculture and manufacturing, 13 per cent in public utilities (electricity, water and post, telephones and telegraphs), 6 per cent in housing and tourism, 20 per cent in roads, ports and airports, 4 per cent in health,

[1] The terms public sector and the government are used interchangeably.

6 per cent in education and vocational training and around 17 per cent in public administration[1].

In terms of its overall outcome, planning in Oman has been successful because it has developed those sectors which were, till the mid-1970s almost non-existent (e.g. manufacturing and tourism) or were very weak (e.g. trade and construction). By raising the contribution of these non-oil activities to the national income, it has reduced the relative importance of petroleum activities in the economy. Thus planning has succeeded in bringing about a structural change in the economy. However, in terms of diversifying and expanding the non-oil productive sectors of the economy, agriculture, fisheries mining and manufacturing, the success has been rather limited. The main reason for this seems to be Oman's neo-classical approach to industrial and trade policies. Another shortcoming has been the failure of the government to control its current expenditure which has indirectly reduced the rate of capital formation and has led to building up of large fiscal deficits. These points are discussed below in our analysis of individual FYPs.

The analyses of the four five-year plans that follows is not meant to be exhaustive in detail in their objectives, outcome and implementation. The aim rather is to focus on some of the salient features of each plan and the way this reflects the effectiveness or otherwise of Omani planning and the uncertain circumstances that this planning had to negotiate.

[1] This includes expenditure of a civil nature incurred by the various Defence and Security units, for example, construction of roads, schools, hospitals, etc.

Table 5.4

Aggregate public and private gross fixed capital formation (GFCF) by sectors and sub-sectors during the four five-year plans (1976-95)

P = Planned, A = Actual, I = Implementation (ratio of actual to plan)

Sector	Public sector[d]					Private sector[d]					Total				
	P		A		I	P		A		I	P		A		I
	RO Mn.	%	RO Mn.	%	%	RO Mn.	%	RO Mn.	%	%	RO Mn.	%	RO Mn.	%	%
1. Crude petroleum activities	1960	24.6	1,926	24.3	98.3	1,882	47.9	1,889	49.6	100.4	3,842	32.4	3,815	32.5	99.3
2. Natural gas	266	3.3	285	3.6	107.5	-		-	-	-	266	2.2	285	2.4	107.5
3. Non-oil mining & quarrying	95	1.2	91	1.1	96.0	5	0.1	1	0.0	20.0	100	0.8	92	0.8	92.2
4. Agriculture	132	1.7	123	1.5	93.0	103	2.6	85	2.2	82.5	235	2.0	208	1.8	88.4
5. Fisheries	86	1.1	36	0.5	42.4	39	1.0	28	0.7	71.8	125	1.1	64	0.5	51.6
6. Manufacturing	335	4.2	138	1.7	41.2	594	15.1	373	9.8	62.8	929	7.8	511	4.4	55.0
7. Construction	-	-	-	-	-	180	4.6	102	2.7	57.1	180	1.5	102	0.9	57.8
8. Goods producing sector (1 to 7)	**2,873**	**36.1**	**2,599**	**32.8**	**90.5**	**2,803**	**71.4**	**2,478**	**65.2**	**88.5**	**5,676**	**47.8**	**5,077**	**43.3**	**89.5**
9. Housing	313	3.9	251	3.2	80.1	841	21.4	1,021	26.8	121.3	1,154	9.7	1,272	10.8	110.2
10. Trade and tourism	163	2.1	207	2.6	126.8	161	4.1	156	4.1	97.5	324	2.7	363	3.1	112.3
11. Electricity and water supply	759	9.5	797	10.1	105.0	-	-	-	-	-	759	6.4	797	6.8	105.0
12. Post, telephones and telegraph	348	4.4	338	4.3	97.2	-	-	-	-	-	348	2.9	338	2.9	97.2
13. Financial institutions[a]	21	0.3	-	-	-	66	1.7	80	2.1	120.9	88	0.7	80	0.7	92.0
14. *Transport*	-	*0.0*	-	-	-	*34*	*0.9*	*66*	*1.7*	*194.1*	*34*	*0.3*	*66*	*0.6*	*193.5*
15. Services sector (9 to 14)	**1,604**	**20.2**	**1,593**	**20.1**	**99.3**	**1,102**	**28.1**	**1,323**	**34.8**	**120.1**	**2,707**	**22.8**	**2,916**	**24.9**	**107.8**
16. Irrigation and water resources	163	2.1	159	2.0	97.4	-	-	-	-	-	163	1.4	159	1.4	97.4
17. Roads	704	8.9	744	9.4	105.7	-	-	-	-	-	704	5.9	744	6.3	105.7
18. Ports	106	1.3	80	1.0	75.8	-	-	-	-	-	106	0.9	80	0.7	75.8
19. *Airport*	67	.8	74	0.9	*109.7*	-	-	-	-	-	67	*0.6*	74	*0.6*	*109.7*
20. Town planning and municipal services	401	5.0	378	4.8	94.1	-	-	-	-	-	401	3.4	378	3.2	94.1
21. Education	328	4.1	411	5.2	125.3	5	0.1	-	-	-	333	2.8	411	3.5	123.5
22. Vocational training	52	0.7	43	0.5	82.1	5	0.1	-	-	-	57	0.5	43	0.4	75.0
23. Health	284	3.6	289	3.6	101.8	5	0.1	-	-	-	289	2.4	289	2.5	100.0
24. Information & cultural affairs[b]	156	2.0	180	2.3	115.9	2	0.1	-	-	-	158	1.3	180	*1.5*	*114.5*
25. Social services[c]	85	1.1	52	0.7	60.9	2	0.1	-	-	-	87	0.7	52	0.4	59.5
26. Public administration[c]	1,128	14.2	1,328	16.8	117.8	-	-	-	-	-	1,128	9.5	1,328	11.3	117.8
27. Infrastructure sector (16 to 26)	**3,474**	**43.7**	**3,738**	**47.1**	**107.6**	**19**	**0.5**	-	-	-	**3,493**	**29.4**	**3,738**	**31.9**	**107.0**
28. Total (8+15+27)	**7,951**	**100.0**	**7,930**	**100.0**	**99.7**	**3,924**	**100.0**	**3,801**	**100.0**	**96.9**	**11,875**	**100.0**	**11,731**	**100.0**	**98.8**

Notes: a) allocations to financial institutions were excluded from GFCF since they were treated as financial investments or support to the private sector; b) cultural affairs include religious affairs; c) includes public buildings and d) see also Appendix tables 5-AI and 5-AII for individual plan data.

Sources: Compiled from Oman, (1976a:p.25); (1986a:pp.19, 22-23 and 30-31); (1991a:p.178); and (1996b:pp.430-431). *Detailed breakdown of actual GFCF for the* Third and Fourth FYP obtained from the Omani Ministry of Development.

5.7 The First FYP (1976-80) : Restoring Stability and Sustaining Development

5.7.1 Objectives of the First FYP : growth and development

The First FYP was meant to restore financial stability and maintain the momentum of development which started in 1970, but in a planned and systematic manner and within the framework of the long-term development strategy.

A number of factors influenced the formulation of the objectives of First FYP. These included, first, the need to extend government services to the South with the end of civil war in that area; second, the threat to Oman's financial stability arising on account of the debt burden created by the large financial commitments of the pre-plan period; third, the fiscal burden of meeting the progressive increase in civil current expenditure; and fourth the expected decline in oil production and its impact on the government's ability to maintain the development momentum (Oman, 1976a:pp.8-11).

Thus the six major objectives of the First FYP (*ibid.*:pp.13-43) were: (i) to achieve high annual average growth rates of 8.1 per cent in the value-added by the non-petroleum activities, to compensate for the expected decline, at an annual average rate of 1.3 per cent in the petroleum sector activities; (ii) to achieve a balance between government revenues and expenditure, by planning for a gradual reduction in government investment through the plan period, from RO 256 million in 1976 to RO 106 million in 1980; (iii) to keep government borrowings within narrow limits, with the aim of reducing government indebtedness by 1979; (iv) to increase the share of private sector investment in total investment from 17.8 per cent in 1974 to an average of 31.0 per cent during the plan period, in order to compensate for the expected decline in the level of government investment; (v) to initiate the industrialisation process by setting up a number of manufacturing industries such as an oil refinery, a cement company and a flour mill, as state owned enterprises or joint ventures with private sector and setting up a development bank to provide long-term finance for private sector activities; and (vi) to achieve by the year 1980 a rate of GFCF, equal to 25 per cent of the nominal GDP, which was expected to reach RO 806 million in that year.

To achieve the above objectives, a number of policies and measures were included in the plan. These included for example, the establishment of special agricultural and fisheries development funds[1] to co-ordinate public investment in these sectors and to act as a policy review board for facilitating development of these sectors; the provision of incentives for the promotion of industry and so on (*ibid.*:pp.44-47).

The sectoral distribution of planned public investment[2], as shown in table 5.3, reflects the priority accorded in the plan to fostering the growth of non-oil activities. Hence about 54 per cent of public investment was allocated to infrastructure projects like roads, port, education and health facilities. And to facilitate private sector investment, about 21 per cent of public investment was allocated to provision of services like electricity, water, hotels and telecommunications, and for setting up a development bank.

To diversify the economy and expand its productive base, RO 235 million, constituting 25 per cent of total planned public investment, was allocated to the goods producing sector[3]. This amount included RO 88 million to cover the government's share in PDO's development expenditure[4], RO 41 million was to be invested in development of the agriculture and fisheries sector, while RO 106 was to be invested in developing the national gas sector and setting up a number of manufacturing units like a refinery, a cement company and a flour mill (*ibid.*:p.29).

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[1] The First FYP emphasised the dominant role of the private sector in agriculture and fisheries: "activities in this sector (agriculture) are mainly left to the private sector and that government investment is meant to assist the private sector and provide guidance to it...[T]he development policy in respect of this sector (fisheries) should include among its principal aims the protection of the traditional fishermen and the development of their production" (Oman, 1976a:pp.39 and 47).

[2] Appendix table 5-AI shows sectoral and sub-sectoral distribution of public investment.

[3] These included oil, gas, non-oil mining and quarrying, agriculture, fisheries and manufacturing.

[4] This was in line with the government's share of 60 per cent in PDO (Oman, 1976a:p.37).

Although the plan was only indicative for the private sector, it was expected that public investment and the various policies and measures included in the plan would "crowd in" private investment. Hence, the plan envisaged that the private sector's investment would reach RO 420 million, representing 31 per cent of total planned investment for the period 1976-80, so that at the end of First FYP in 1980, the ratio of private investment to GDP would reach 11.8 per cent compared to 6.5 per cent achieved in 1976 (cf. table 5.2).

As table 5.3 indicates, private sector was expected to invest RO 420 million in the goods producing and services sector[1]. This was almost equal to public investment of RO 428 million planned for these two sectors. Thus, the plan envisaged that by the end of the First FYP in 1980, the share of private investment in total investment[2] in goods producing and services sectors would reach about 49 per cent (*ibid.*:p.27).

The plan recognised the prevalence of regional inequalities in the country and therefore 32 per cent of the planned public investment was allocated for the capital area, 27 per cent for the Southern region and 41 per cent for other regions (cf. table 5.5). This pattern of regional allocation reflected the population distribution of the country. In fact Speece's (1989) prognosis which we discussed in the Introduction has proven to be overly pessimistic.

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[1] It will be noticed from table 5.3 that private sector was not expected to make any investment in economic and social infrastructures.

[2] That is the combined public and private investment.

Table 5.5
Geographical distribution of public investment - 1976-80

Region	Planned		Actual	
	RO Mn.	%	RO Mn.	%
Capital area	300.3	32.1	334.8	27.8
Southern region	253.6	27.1	300.9	25.0
Other regions	380.9	40.8	567.9	47.2
Total	**934.8**	**100.0**	**1,203.6**	**100.0**

Sources: Data for plan from First FYP, Oman (1976a:p.34). Data for actual investment from Second FYP[1] (Oman, 1981a:p.55).

5.7.2 Outcome of the First FYP : stabilisation and growth

The period of the First FYP coincided with the period of rising oil prices[2]. As a result, the value-added by the petroleum activities which was expected to decline at an average rate of 1.3 per cent during the years 1976-80, in fact grew at an average annual rate of 21.3 per cent. And whilst its relative share of GDP was expected to decline to 57 per cent in 1980, it actually increased to 62 per cent. Consequently, the nominal GDP grew at an annual average rate of 23.3 per cent, compared to the planned target of 2.2 per cent, and in 1980, total GDP reached RO 2,064 million, compared to the planned target of RO 806 million (cf. table 5.1).

However, within the non-oil sector, the performance at sectoral and sub-sectoral level was quite uneven. Thus while the average annual growth of 49.3 per cent in the manufacturing sector was below the targeted rate of growth of 64.1 per cent, the services sector's annual average rate of growth of 32.5 per cent was more than three times its targeted growth rate of 10.1 per cent. Similarly, while the rate of growth of 21.1 per cent recorded by agriculture and fisheries was almost two and half times its targeted growth

[1] The data in the Second FYP about the actual level of public investment of RO 1,203.6 million are based on preliminary estimates of 1980 public accounts. These estimates were revised to RO 1,187 million later on, as table 5.3 shows, however, since no geographical distribution is available for the later amount, we have used the geographical distribution available for the former.
[2] Because of the Iranian revolution in 1979, and the Iran-Iraq war in 1980 the average oil price per barrel increased from US$ 13 in 1976 to US$ 37 in 1980 (see Appendix table 4-AII of Chapter IV).

rate of 8.2 per cent, yet its performance was below that of the petroleum and services sector.

In terms of the demand in the economy, both final consumption and capital formation grew very rapidly. As table 5.2 shows, about 52 per cent of the demand in 1980 was contributed by final consumption. Final consumption was planned to grow by 4 per cent between 1976-80 (from RO 411 million to RO 426 million), but actual final consumption between these years grew by about 155 per cent (from RO 422 million to RO 1,076 million). The expenditure on GFCF was planned to decline by 36 per cent (from RO 314 million to RO 201 million) between 1976 and 1980, but it actually increased by 47 per cent, from RO 317 million to RO 466 million during the period.

The financial position of the government, as table 5.6 below shows, also improved during the First FYP. The large fiscal deficits experienced during the period preceding the First FYP were wiped out and public finances actually showed a surplus of revenue over expenditure of RO 265[1] million.

Employment also grew substantially. The number of persons employed in the civil service increased from about 19,123 in 1975 to 38,840 in 1980. Expatriate employment in the private sector doubled from about 65,000 persons in 1975 to about 130,000 persons in 1980 (Oman, 1986b:pp.99 and 114).

[1] This is before transfer to reserves. Actual deficit, after transfer of RO 274 million to reserves, was RO 9 million (cf. table 5.6).

Table 5.6

Public finance-total revenues, expenditure and deficit - plan compared with actual (1976-95)

P = Planned, A = Actual, I = Implementation (ratio of actual to plan)

(Amount in RO Million)

Item	First Plan (1976-80)	Second Plan (1981-1985)	Third Plan (1986-90)	Fourth Plan (1991-1995)	Cumulative of Four Plans (1976-1995)
Total Revenues					
Plan	**2,393**	**6,947**	**6,491**	**8,571**	**24,402**
Actual	**3,116**	**6,605**	**7,098**	**8,598**	**25,417**
Implementation (%)	**130.2**	**95.1**	**109.4**	**100.3**	**104.2**
Gross Oil Revenues					
Plan	2,236	7,501	5,045	8,156	22,938
Actual	3,125	6,649	6,016	7,282	23,072
Implementation (%)	139.8	88.6	119.2	89.3	100.6
Less: Transfer to reserves					
Plan	-	1,125	-	1,570	2,695
Actual	274	920	405	779	2,378
Implementation (%)	-	81.8	-	49.6	88.2
Net oil revenues					
Plan	2,236	6,376	5,045	6,586	20.243
Actual	2,851	5,729	5,611	6,503	20,694
Implementation (%)	127.5	89.9	111.2	98.7	102.2
Other revenues					
Plan	157	571	1,446	1,985	4,159
Actual	265	876	1,487	2,095	4,723
Implementation (%)	168.8	153.4	102.8	105.5	113.6
Total expenditure					
Plan	**2,631**	**7,368**	**8,164**	**9,450**	**27,613**
Actual	**3,340**	**7,872**	**8,616**	**10,953**	**30,781**
Implementation (%)	**126.9**	**106.8**	**105.5**	**115.9**	**111.5**
Current expenditure					
Plan	1,820	5,138	6,055	7,214	20,227
Actual	2,348	5,518	6,726	8,674	23,266
Implementation (%)	129.0	107.4	111.1	120.2	115.0
Defence					
Plan	971	2,973	2,716	2,904	9,564
Actual	1,449	3,247	3,181	3,714	11,591
Implementation (%)	149.2	109.2	117.1	127.9	121.2
Civil					
Plan	774	2,026	2,890	3,778	9,468
Actual	824	2,132	3,125	4,475	10,556
Implementation (%)	106.5	105.2	108.1	118.4	111.5

Table 5.6 contd...

Table 5.6 contd...

Item	First Plan (1976-80)	Second Plan (1981-1985)	Third Plan (1986-90)	Fourth Plan (1991-1995)	Cumulative of Four Plans (1976-1995)
Interest on loans					
Plan	75	139	449	532	1,195
Actual	75	139	420	485	1,119
Implementation (%)	**100.0**	**100.0**	**93.5**	**91.2**	**93.6**
Development					
Plan	811	1,961	1,932	2,107	6,811
Actual	903	2,088	1,719	2,148	6,858
Implementation (%)	111.3	106.5	89.0	101.9	100.7
Oil					
Plan	88	544	578	761	1,971
Actual	205	456	561	739	1,961
Implementation (%)	233.0	83.8	97.1	97.1	99.5
Civil					
Plan	723	1,417	1,354	1,346	4,840
Actual	698	1,632	1,158	1,409	4,897
Implementation (%)	96.5	115.2	85.5	104.7	101.2
Equity participation and support to private sector					
Plan	-	269	179	129	577
Actual	89	266	171	131	657
Implementation (%)	-	98.9	95.5	101.6	113.9
Surplus (+) or Deficit (-)					
Plan	-238	-421	-1,673	-879	-3,211
Actual	-224	-1,267	-1,518	-2,355	-5,364
Implementation (%)	94.1	+300.0	90.7	267.9	167.0
Less: Aid received					
Plan	116	37	-	-	153
Actual	215	179	3	21	418
Implementation (%)	185.4	483.8	-	-	273.2
Net deficit					
Plan	-122	-384	-1,673	-879	-3,058
Actual	-9	-1,088	-1,515	-2,334	-4,946
Implementation (%)	7.4	283.3	90.6	265.5	-161.7

Sources: Data for Plan figures compiled from: First plan (Oman, 1976a:p.19); Second Plan (Oman, 1981a:p.40); Third Plan (Oman, 1986a:p.35) and Fourth Plan (Oman, 1991a:pp.84-85). Data for Actual figures compiled from: First plan (Oman, 1986b:p.378); Second Plan (Oman, 1986b:p.379); Third Plan (Oman, 1991a:pp.84-85); and Fourth Plan (Oman, 1996a:pp.85-89).

During the First FYP, considerable progress was made in the provision of basic infrastructural services (such as ports, roads etc.), public utilities (electricity, water, post and telecommunications), educational and health facilities which we described in Chapter IV.

A number of income-generating projects were also completed during the First FYP by the state on its own or jointly with private sector. These included — one flour mill, two factories for processing of dates, a fishing company and an animal husbandry company. Other projects which were started included a copper mining and smelting project, one cement factory and one oil refinery (Oman, 1981a:pp.4-6). The Oman Development Bank, a fishermen's support fund, and a farmers' support fund were also set up, as planned. The Oman Housing Bank[1] was also strengthened and its activities were expanded. The public debt, which consisted mostly of short-term debt before the First FYP was also reconstructed through increased recourse to grants and concessional medium- and long-term loans. In 1980 this amounted to RO 178 million (Oman, 1996a:p.25).

Another positive effect of the oil price increase was that a number of southern oil fields which were hitherto unfeasible, became commercially viable for the first time. As a result the government was able, through the agreement[2] signed in May 1977, to provide additional incentives to the foreign partners in PDO to develop the southern oil fields (Al Yousef, 1995:p.31).

[1] This bank was set up in 1973 under the name of "The Omani National Company for the Development of Housing". During the First FYP, in 1977, the company was converted to the "Oman Housing Bank" (Oman, 1981a:p.121). The objective of the Bank is to provide long-term low cost loans to Omanis for building their own houses.

[2] This agreement in fact did not relate only to the southern oil fields but covered all the areas falling under the concession area operated by PDO including the existing producing fields. In fact the agreement could be construed as very generous, since it allowed for all investments by the foreign partners to be recovered in less than five years, a guaranteed income of US 23 cents per barrel on all oil produced, indexed to the buy-back price of Omani crude, and a return of 7.5 per cent on their share of PDO's average assets (Al Yousef, 1995:p.31).

The increase in oil prices also enabled the government to increase the level of planned investment for the oil sector from RO 88 million to RO 205 million in the First FYP (cf. Appendix table 5-AI). Consequently oil reserves increased from 1,280 million barrels in 1976 to 2,484 million barrels in 1980 (cf. Appendix table 4-AII, Chapter IV).

5.7.3 First FYP and the oil boom

An important contributory factor in achieving the goals of the First FYP was the increase in the price of oil. The consequent rise in oil revenues enabled the government to expand public services and increase the level of public investment. However, despite the overall positive outcome of the First FYP, there were also a number of shortfalls which could partly be attributed to the oil price increase and the consequent expansion in public expenditure.

An important negative implication of the increase in oil price that reflected the Dutch disease syndrome was that both the agriculture[1] and the manufacturing sectors could not achieve the plan targets of their contribution[2] to GDP. In 1980, the actual contribution of agriculture to GDP was 2.5 per cent compared to the plan target of 3.7 per cent. Similarly, in 1980 the manufacturing sector's actual contribution of 0.8 per cent to GDP was far lower than the plan target of 3.1 per cent.

The oil boom also had the negative effect of increasing Oman's reliance upon purchase of services from abroad and expatriate workers. In 1980, the actual payments on account of these two items jumped to RO 212 million compared to the target of RO 102 million (cf. table 5.2). This was primarily due to a large increase in the number of expatriate workers both in the civil service and in the private sector[3].

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[1] Agriculture includes fisheries, whenever it is not explicitly mentioned.

[2] This means the value-added in these sectors contribute to the production in the economy as measured by GDP.

[3] Between 1975 and 1980, the number of expatriates in civil service increased from 4,000 to 15,384 while in the private sector their number increased by about 65,000 to reach 130,208 during the same period (Oman, 1986b:pp.99 and 114).

The large expansion in public current expenditure that was fuelled by rising oil revenues, is another negative aspect of the oil boom. As table 5.6 shows, whilst the actual development (investment) expenditure during the First FYP was 11 per cent above the planned target, the current expenditure exceeded the target by about 27 per cent.

Inspite of shortcomings of the First FYP, it did meet many of its objectives. This indicates the important role the state can play, in promoting development through planning. By launching an effective public investment programme and "crowding in" private sector investment, the state in Oman was able to achieve high growth rates without neglecting the social dimension of development, as we discussed in Chapter IV. Many oil producing developing countries such as Algeria, Trinidad and Tobago, Venezuela and Ecuador spent the oil windfalls on expanded programmes of subsidies and transfers to hold down the rate of inflation and support loss-making firms (Gelb, 1986:p.86). These programmes proved hard to curb when oil revenues fell. In contrast, the discipline imposed by the planning system prevented Oman from indulging in such practices. Similarly, a number of oil producing countries were reluctant to raise domestic oil prices, to conform to international prices, and chose to pass part of the windfall to domestic consumers in the form of lower prices[1] (*ibid.*). But in Oman, before the Oman Refinery started in 1982, domestic oil prices fully reflected international prices. And to rationalise domestic consumption and maximise oil exports, a tax[2] of 50 per cent was imposed on domestic consumption when the refinery started its operations (Al Yousef, 1995:p.39).

[1] Energy subsidies in 1980 were estimated to be equivalent to almost 10 per cent of household income in Ecuador, while fiscal subsidies rose sharply in Trinidad and Tobago to around 7 per cent of GDP or 11 per cent of non-mining GDP (Gelb, *op. cit.*).

[2] Half of the crude oil supplied to the refinery — i.e. the quantity estimated for domestic consumption is priced at US$ 30 per barrel, almost twice its 1994 international price for example, while the other half is priced at prevailing price (*ibid.*).

5.8 The Second FYP (1981-85) and the Crisis of Planning

5.8.1 Objectives of the Second FYP — spending the oil windfalls

The objectives of the Second FYP were influenced by a number of favourable factors. These included: first, the newly explored oil fields had become economically viable due to the rise in oil prices during the late 1970s; second, the consequent increase in oil revenues enabled the government to spend more on development as well as on the maintenance of an expanded bureaucracy; and third, the comprehensive infrastructural investment undertaken during the First FYP period had augmented the absorptive capacity of the economy by removing bottlenecks in ports and transportation and thereby contributing to the growth of the markets and increased competition (Oman, 1981a:p.31).

The setting of challenging targets for the Second FYP and establishment of new institutions like the SGRF[1] and soft loan schemes for private sector were also influenced by the strong oil market prevailing[2] in 1979-80.

Within this context the Second FYP (Oman, 1981a:pp.32-33) set out to achieve six major objectives of which the main ones were:

i) to achieve an average annual growth rate of 13.1 per cent in Gross Domestic Product at current prices during the Second FYP period, 1981-85 (cf. table 5.1);

ii) to raise the ratio of GFCF to GDP to 25.6 per cent in the last year of the Second FYP, 1985, about two thirds of this was planned to be contributed by the public sector, and the remaining 35 per cent by the private sector (cf. table 5.2);

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[1] This was established in 1980 but formalised within the framework of the Second FYP (*ibid.*:p.32). Section 5.4 provides more details about the operation of the SGRF.

[2] In view of the Iraq-Iran war, it was expected that the high oil prices then prevailing i.e., US$ 36.9 per barrel, would continue and even move upwards. Although the prices at which oil revenues were estimated are not shown in the plan, it appears that the price estimated for 1985, for example, was about US$ 39 per barrel.

iii) to provide a strong stimulating push to the private sector engaged in productive activities in agriculture, fisheries, manufacturing, mining and handicrafts, a new programme of financing was introduced for this purpose.

The plan also laid down objectives for education, health and other social sectors.

5.8.2 Performance of the Second FYP : fiscal expansion and the neglect of planning

All the problems that affect economies based on export of primary commodities which we have discussed previously, especially in Chapter II, are manifest during implementation of Oman's Second FYP.

The very high average annual growth rates in nominal GDP targeted in the plan could not be achieved mainly because of a large decline in the average oil price. After continuing at its average peak price of US$ 36.9 per barrel in 1981, the oil price declined to US$ 34 in 1982 and further to US$ 27 per barrel in 1985 (Oman, 1996a:p.22).

As table 5.1 shows, the average annual growth rate of 10.9 per cent in the GDP during the Second FYP period was much lower than the targeted average annual growth rate of 13.1 per cent. For the petroleum sector, the shortfall was even much greater. The average annual growth rate of 5.5 per cent was less than half the targeted growth rate of 13.0 per cent.

In contrast, average annual growth rate realised in the non-oil activities of about 17.8 per cent was much higher than the targeted growth rate of 13.4 per cent. Within the non-oil sector, with the exception of agriculture, the growth rates recorded by all other activities were higher than planned.

The paradoxical role of oil in Oman's economy is reflected in the fact that because of the decline in the petroleum sector, the relative share of the value-added by non-oil activities in nominal GDP increased to about 52 per cent in 1985 compared to the plan target of 32 per cent. But as table 5.1 shows, a major part of the increase in the value-added in these activities was recorded by the services sector whose relative share in GDP increased to 38.1 per cent compared to the plan's target of 21.1 per cent. The relative shares of agriculture and fisheries, and manufacturing, which stood at 2.7 and 2.4 per cent respectively in 1980 exceeded their targeted shares of 2.2 and 2.3 per cent respectively. However, the increase in these sectors was much smaller than the increase in the services sector.

Associated with the unplanned increase in the share of services in the production of the economy was the large unplanned growth of final consumption. As table 5.2 shows, while the final consumption was planned to contribute around 45 per cent of the total demand in the economy in 1985, its actual contribution reached around 60 per cent of GDP. Therefore, most of the demand had to be satisfied by way of additional purchase of goods and services from abroad because the increase in domestic production of agriculture and manufacturing, as noted earlier, was not high enough to meet this demand.

Total GFCF of RO 3,302 million recorded during the Second FYP period exceeded the plan target of RO 3,129 million by 5 per cent because actual public investment of RO 2,165 million exceeded the plan target of RO 1,961 million by 10 per cent. Private sector investment of RO 1,137 million was lower than the targeted level of RO 1,168 million by 3 per cent. As a result, the share of private sector in total investment was 34 per cent compared to the plan target of 37 per cent (cf. table 5.3).

The success in implementation of public investment programme among different sectors varied from one sector to another. As Appendix table 5-AI shows, the rate of implementation i.e. ratio of actual to planned investment in agriculture was 72 per cent and in fisheries it was only 35 per cent. In the manufacturing sector implementation seems to have improved with experience, since the implementation rate was 94 per cent whereas in the First FYP it was only 11 per cent. This was partly due to the completion of a number of large industrial projects, started in the First FYP, such as the oil refinery and the cement factory.

The performance of the private sector in implementing the investment programme followed the pattern of the public sector. Thus actual total private investment was 97 per cent of planned investment in Second FYP. But between different sectors, the rate of implementation of private investment was quite uneven. As Appendix table 5-AII shows, for the services sector[1] actual private investment exceeded planned private investment by 16 per cent. But in the goods producing sector — with the exception of investment in petroleum sector — the record of implementation of private investment in the agriculture, fisheries and manufacturing sectors — as shown by the ratios of actual to planned private investment — was even poorer than what it was in the First FYP[2]. The low level of implementation in these sectors may, to some extent, reflect the low implementation rates of public investment in these sectors.

During the Second FYP, total export earnings (including re-exports) increased by 33 per cent, from RO 1,294 million in 1980 to RO 1,717 million in 1985, recording an average annual growth rate of 5.8 per cent. Oil exports grew at an average annual growth rate of 5.1 per cent, while the growth rates of non-oil exports of Omani origin and re-exports were much higher at 35.7 per cent, and 16.6 per cent respectively (Oman, 1986b:p.281).

However, despite the increase in oil exports, Oman's terms of trade started to decline along with the decline of oil prices that started in 1982. Thus, Oman's terms of trade declined by 14 per cent in 1984 compared to their level in 1980 (World Bank, 1988:p.243). To compensate for this decline, Oman increased its oil production between

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[1] The rate of implementation i.e. ratio of actual to planned private investment in the sub-sectors of services was: Financial Institutions, 278 per cent; Transport, 260 per cent; Trade and Tourism, 115 per cent; and for Housing, implementation rate was 108 per cent.

[2] For agriculture the implementation rate was 78 per cent (compared to 81 per cent in the First FYP); for Fisheries it was 26 per cent and for Manufacturing it was 43 per cent (95 per cent in First FYP) (see Appendix table 5-AII).

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1,267 million[1]. About 48 per cent of this large deficit was financed through withdrawals from the SGRF, 38 per cent was financed by loans from international commercial banks and Export Credit Agencies, while 14 per cent was funded through aid received from friendly countries (Oman, 1986b:p.379).

In terms of other objectives of the plan, the outcome was very positive. In the agriculture and fisheries sector, for example, a number of measures were undertaken by the government to develop this sector[2]. Similarly, a number of industrial projects[3] were completed during the Second FYP.

In the private sector also many units for production of soft drinks, mineral water, beverages, cooking oil, petrochemicals, plastic and insulators (polystyrene), detergents, packing materials (cartons) and fishing boats were established during the Second FYP. The government also started providing, as planned, for the first time subsidised long-term finance to the private sector industry, mining and quarrying — this was in addition to the loans provided by the Oman Development Bank (Oman, 1986a:pp.3-8).

Between 1981 and 1985, 3,374 low cost houses were built, and the Oman Housing Bank extended loans of RO 85 million for construction of houses during this period (*ibid.*). In education, health care, provision of infrastructure and public utilities considerable progress was made during the Second FYP period.

[1] As table 5.6 shows, about 40 per cent or RO 342 million of the increase in the deficit was contributed by the fall in revenues, while the remaining 60 per cent, RO 504 million, was the result of the increase of public expenditure over the planned level.

[2] Establishment of agricultural research stations and extension service centres, provision of subsidies to farmers for improved seeds, insecticides and fertilisers, repair and maintenance of many falajs, and digging of deep wells. For fisheries, the government extended support to the private sector by participating in the formation of the Oman National Fisheries Co. (Oman, 1986a:p.3). Similarly, the Oman Bank for Agriculture and Fisheries was set up in 1982, and between then and 1985, the Bank extended soft-loans amounting to RO 13.2 million.

[3] These included, the oil refinery, two cement factories, (one wholly owned by the government — Oman Cement Company and the other Raysut Cement Company a public-private joint venture) and the animal feed factory (a joint venture with private sector) (Oman, 1986a:pp.3-8).

5.8.3 The importance of planning during the Second FYP period

The experience of Second FYP suggests that adoption of the neo-classical policy of unrestricted imports of goods and services, including expatriate labour, has led to certain adverse consequences for the Omani economy. These included, for example, a large increase in expatriate remittances, which grew by 139 per cent from RO 137 million in 1980 to RO 327 million in 1985 (Oman, 1986b:p.323). These remittances had two-fold effects: they reduced substantially the external account surplus and widened the gap between gross domestic and gross national savings. Moreover, the better trained and relatively low cost expatriate labour created an unfair competition for the Omani labour who could not accept the same level of wages[1]. Similarly, the liberal trade policy of providing minimum protection to domestic producers led to an unfair competition for the Omani infant industries as well as the agriculture and fisheries sector. This not only led to a surge in imports but also encouraged the private sector to invest more in the services sector, which did not face similar competition. Hence, as we noted earlier, actual private investment in services sector was higher than planned investment whereas in agriculture, fisheries and manufacturing, actual private investment was much lower than planned (cf. Appendix table 5-AII).

Moreover, a lax fiscal policy and the neglect of planning during the years 1983-85 eventually led to a large increase in fiscal deficit, a consequent increase in final consumption, a decline in gross national savings[2], and erosion of the current account surplus.

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[1] The expatriate labour would accept low wages because of the supply exceeding demand in their home countries, and because the value of Omani Rial compared to their home currencies was much higher. In fact, the Omani Rial compared to these currencies is over-valued. For example, while the purchasing power parity of the Omani Rial compared to the US Dollar was about 1.8 (units of the US currency) to 1 (unit of the Omani currency) in 1987, for India it was 2.55 to 1, Pakistan 5.1 to 1, Bangladesh 4.2 to 1, and Sri Lanka it was 5.0 to 1 in 1987 (calculated from UNDP, 1991:pp.152-153).

[2] As table 5.2 shows, gross national savings declined from 37.6 per cent of GDP in 1980 to 28.7 per cent in 1985. Although such a level of savings is much higher than the level of 10-15 per cent of national income suggested by Lewis (1955) and Rostow (1956), as we discussed in Chapter II, but it is the declining trend which is of concern.

Oman's experience during the Second Plan is instructive about the applicability of free trade policy advocated by the neo-classicals. In a country like Oman where the private sector is underdeveloped, the economy is reliant on a single primary produce, and the markets and their supportive institutions are in their infancy, this policy has adverse implications.

During this period (1982-85) political support and commitment to planning weakened somewhat. So that whilst the Development Council would meet at least three to four times a year to review the progress in plan implementation, because of waning political support for planning[1] during 1982-85, the Council held only two meetings in 1982 and did not meet in 1983, 1984 and 1985.

An irony of the crisis in planning faced during the Second FYP lies in the fact that while the crisis was due to the neglect of the planning institutions and processes[2], the resolution of this crisis was found within those very processes and institutions. Thus the facilitating institutions, such as the SGRF, which were set up within the planning framework, enabled the government to overcome the problems of large unplanned fiscal deficit during the Second FYP. Without planning the Omani economy would have experienced greater shocks and much less continuity.

5.9 The Third FYP (1986-90) : Stabilisation with a Human Face

5.9.1 Objectives of the Third FYP : managing external shocks of the 1980s

The situation prevailing at the time of the formulation of the Third FYP in 1985 and the unfolding of oil crisis in 1986 were a real testing time for development planning in

[1] The waning support for planning in these years was not due entirely to any perceived failure of the planning system. It was the euphoria created by the oil windfalls of the early 1980s which led a number of policy makers to believe that relying on planning mechanism would frustrate the speed of development. Hence a fast track of public investment programme was advocated.

[2] In the form of inclusion of non-plan projects and consequent increase in public expenditure leading to unplanned increase in fiscal deficits.

Oman. The Third FYP had on the one hand, to take due cognisance of the possibility of continued recession in oil trade by making the necessary macroecnomic adjustments, and on the other, it had to ensure that adequate resources were available for completing the large number of ongoing projects[1] started during the Second FYP[2].

Anticipating the continuation of the downward trend in the world oil prices, the planners in Oman prepared the Third FYP estimates of oil revenues, export earnings and oil sector's contribution to GDP on the basis of an expected average oil price of US$ 23.65 per barrel which was much lower than the average price of US$ 27 per barrel realised in 1985 (Oman, 1986a:p.75). To offset the effect of this decline, it was planned to increase the daily oil production gradually from 498,000 barrels in 1985 to 575,000 in 1990 (*ibid.*:p.48).

However, subsequent to the approval of the Third FYP on January 1, 1986, oil prices declined much faster than expected and plummeted to US$ 8 per barrel in 1986 compared to the projected price of US$ 24 (Oman, 1986a:p.50). As a result, it was estimated that oil revenues would drop by almost 50 per cent if the trend of low prices was to continue. Because of oil's strong fiscal and monetary linkages to the rest of the economy this meant that the latter was to experience negative repercussions (*ibid.*).

In order to minimise the negative consequences of the oil crisis on the economy and the society as a whole, the government undertook a number of policy measures, including reformulation of the Third FYP to take account of the severe recession in oil market; devaluation of the Omani Rial by 10.2 per cent in 1986 against the US dollar[3];

[1] The cost to complete these ongoing projects was RO 733 million and in fact represented almost 50 per cent of the total development expenditure programme for the Third Plan. About 30 per cent of the cost of the ongoing projects related to projects which had been added to the Second Plan, which we discussed in the preceding section, while a large part of the balance related to projects that had been postponed during the Second Plan (Oman, 1986a:pp.48-49).

[2] Because the Third Plan was basically a fiscal consolidation plan, the Third FYP was the first plan to be discussed and formulated by the Financial Affairs Council instead of the Development Council, which was normally responsible for plan formulation and evaluation.

[3] The parity of the Rial was thus reduced from US$ 2.89 to US$ 2.60 on 25th January, 1986 (*ibid.*:p.50).

reduction of transfers to the SGRF from 15 per cent of gross oil revenues to 5 per cent; curtailment of all public expenditure except expenditure on education, health and social affairs[1], by 10 per cent. The last measure shows Omani policy makers' commitment to social welfare in Oman (Oman, 1986a:p.50).

The revised Third FYP, like its original version, had to take into account the cost of completing several on-going projects started during the later part of the Second FYP. Two other policy changes with long-term implications included, measures to enhance the scope of private sector activities in development and sale of some government assets. Thus privatisation as a part of macroeconomic stabilisation was introduced for the first time in Oman.

The Financial Affairs Council[2] prepared the revised version of the Third FYP in October 1986 which in effect was a structural adjustment plan. As table 5.7 shows, because of the collapse in oil prices from the beginning of 1986, oil revenues were expected to be 30 per cent lower than the original estimates. On the expenditure side, the alternatives available to the government were limited by the decisions[3] made during the Second FYP. It was therefore difficult to reduce public current expenditure substantially without causing large scale redundancies and social hardship. Keeping in view the policy decision of not reducing expenditure on health, education and social affairs, the revised estimate of total expenditure was lower than the original by only 12 per cent. As a result, fiscal deficit during the Third FYP period was allowed to increase from RO 596 million to RO 1,673 million, representing a 180 per cent increase.

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[1] It is most significant that Oman did not reduce expenditure in these areas. In most other countries — developing and developed, reduction in expenditure on education, health and social affairs is only too readily made in times of fiscal crisis.

[2] In view of the wide-ranging fiscal implications of the oil crisis, the revised Third FYP was also formulated by the Financial Affairs Council and not by the Development Council.

[3] These included on the one hand, the financial burden of completing a large number of ongoing projects and the cost of maintaining and operating them, and on the other, the increasing cost of maintaining a large bureaucracy and a wide range of public services that had been significantly expanded during the Second FYP.

Table 5.7

Comparison between estimates of government revenue and expenditure : original Third FYP compared with revised Third FYP (1986-90)

(RO Million)

	Original plan	Revised plan	Percentage change
Revenues			
Oil	7,171	5,045	-30
Others	1,485	1,446	-3
Total revenues	**8,656**	**6,491**	**-25**
Expenditure			
Current	6,818	6,055	-11
Development	2,211	1,932	-13
Support to private sector and participations	221	177	-20
Total expenditure	**9,250**	**8,164**	**-12**
Deficit	**594**	**1,673**	**+182**
To be financed through:	-	-	-
Grants and Loans	294	298	-
Withdrawals from reserves	300	1,026	+242
Sale of government assets	-	100	
Total financing of deficit	**594**	**1,424**	**+139**
Uncovered deficit	-	**249**	-

Source: Oman, *Third FYP* (1986a:pp.51-52).

During the first half of 1987, the Development Council[1] took an active role in defining the plans targets, outlining the policies required to achieve the necessary adjustment and selecting the projects that need to be implemented during the Third FYP.

The revised plan and as table 5.1 shows, envisaged an average annual decline of 2.4 per cent in nominal GDP. With the expectation of continuing depression in the oil market, the value-added by the petroleum sector was forecast to decline at an average annual rate of 6.3 per cent. This was planned to be partly offset by the growth in the value-added by the non-oil sector, at an average annual rate of 0.7 per cent.

[1] In fact, for this purpose, the Council held 18 meetings in 1987, more than the number of meetings held in any year since its formation in 1974.

Consequently, the contribution of the petroleum sector to nominal GDP was planned to decrease to 39 per cent at the end of the Third FYP (1990) compared to 48 per cent recorded in the last year of the Second FYP (1985), whereas the contribution of the non-oil sector was planned to rise to 61 per cent in 1990 compared to 51 per cent in 1985.

The ratio of gross capital formation to GDP in 1990 was targeted to decline to 17.2 per cent compared to the ratio of 27.6 achieved in 1985 (cf. table 5.2). As table 5.3 shows total planned investment during the Third FYP was envisaged to be lower at RO 3,294 million compared to the investment expenditure of RO 3,302 million incurred during the Second FYP period[1].

5.9.2 Performance of the Third FYP : growth with adjustment

As mentioned earlier, the revised Third FYP was essentially a *structural adjustment* plan whose basic goal was to enable the economy to adjust to the sharp decline in oil prices, and their consequent adverse effects on government revenues, with minimum dislocation.

The outcome of the Third FYP, clearly shows that the policy measures undertaken at the outset of the oil crises were largely successful. These enabled Oman to absorb the shock of oil price collapse without losing the momentum of development and without curtailing the public expenditure on social services. While the success of these policies was proven by the speed with which the economy adapted to the new circumstances, the resilience shown by Oman's economy to the oil crisis proved the soundness of the national economic base and the suitability of planning as a method of achieving economic

[1] In fact, actual investment expenditure in the Second FYP was RO 3,893 million and not RO 3,302 million as shown in table 5.3. The reason for this anomaly is that since the plan's estimates of public investment excluded any forecast of capital expenditure of civil nature to be incurred by Defence and Security Units during the plan period, the actual capital expenditure of these units has therefore been excluded from table 5.3, when compiling the data for the outcome of the Second FYP. Whereas, the Third FYP estimates of RO 3,294 million of total public investment include an amount of RO 175 million to be spent by these units on capital expenditure of civil nature (Oman, 1986a:p.67).

development in a primary resource-based economy like Oman. In contrast to the imbalances created during the Second FYP through unplanned development, the favourable outcome of the Third FYP showed that it was possible to deal with external shocks by taking remedial measures within the framework of development plans. In the absence of the planned response to the sudden emergence of unfavourable external factors, the Omani economy and society might well have experienced the dislocation and imbalance suffered by other developing countries.

The Third FYP's outcome also reflects the control exercised by the government in the management of public finance. Although gross oil revenues realised during the Third FYP, because of lower oil prices[1], were lower than the revenues realised during the Second FYP by about 10 per cent, the government did not fail in its commitment of transferring a part of oil revenues to the SGRF[2] (cf. table 5.6). This indicates the importance given to the sustenance of these reserves as an instrument for managing oil price fluctuations, and the discipline which planning imposed on economic management in Oman.

The government's control over financial policy is also shown in its cautious approach to public debt observed during the Third FYP. Despite the fact that the Third FYP period coincided with the worst oil crisis, the government of Oman did not resort to heavy public borrowing. Only 20 per cent of the fiscal deficit arising during 1986-90 was financed through loans (Oman, 1991a:p.85). Thus compared to 1985, total public external debt increased only from 24.1 per cent of GNP in 1985 to 29.4 per cent of GNP in 1990 (cf. table 5.8).

The government also maintained its policy of allocation of adequate funds for developing the oil sector. The consequent increase in oil reserves enabled the government

[1] During 1981-85, the average oil price realised was US$ 31.1 per barrel, whereas, during 1986-90, the average price realised was US$ 16.3 per barrel (Oman, 1996a:p.22).
[2] Of course, this was at a reduced rate of 5 per cent of gross oil revenues compared to the rate of 15 per cent during the Second FYP period.

to compensate the substantial decline in oil price with increased production, without excessive depletion of oil reserves. As Appendix 4-AII of Chapter IV shows, oil reserves increased from 3,869 million barrels in 1985 to 4,161 million barrels in 1990, while the average oil production of 684,000 b/d in that year was much higher than the targeted level of 575,000 b/d.

However, as was the case in the Second FYP, the control on current public expenditure could not be maintained during the Third FYP. Table 5.6 shows that actual development expenditure of RO 1,719 million was lower than the revised plan target of RO 1,932 million. However the current expenditure increased to RO 6,726 million as against the planned target of RO 6,055 million. In fact, total current expenditure in the Third FYP was higher by almost 22 per cent than total current expenditure of RO 5,518 million in the Second FYP. The overruns in current expenditure, as we also noted in the preceding section, have been a permanent aspect of Oman's lax fiscal management.

5.9.3 The Third FYP : the impact of the structural adjustment on growth and human development

Unlike many oil exporting developing countries[1] which implemented structural adjustment programmes prescribed by the IFIs, Oman had the freedom to design its own adjustment measures. It was able to do so because Oman used planning as an instrument to achieve adjustment with growth and human development. Similarly, planning did not preclude Oman from using the neo-classical approach of policy reform wherever it was considered appropriate, neither did planning lead Oman to abandon its liberal trade and exchange rate policy, by introducing exchange controls and import restrictions.

[1] With the exception of Oman, Trinidad and Tobago and Saudi Arabia, all countries listed in table 5.8 underwent either one or more structural adjustment programmes. Some of these were supported either by stabilisation loans from the IMF or by structural adjustment loans from the World Bank or from both of these institutions (Thomas, *et al.*, 1991).

Moreover, Oman's experience is rather unique in that, while most of the IFIs sponsored SAPs concentrate on improving the economic variables[1] at the expense of social welfare, Oman's main concern was to protect education, health and social welfare programmes from any negative impact of its adjustment programme.

In comparing Oman's growth performance during the period 1980-90[2] with a selected number of oil exporting developing countries, we find from table 5.8 that Oman achieved the highest average growth rate of the countries listed in the table below. Oman's performance was even better than that of Indonesia[3], (which is regarded as a success story) which achieved an average annual growth rate of 6.1 per cent.

In terms of human development, Oman was able to add 12 years to the average life expectancy between 1985 and 1990, more than any other country listed in the table below, and in 1990, (with the exception of Trinidad and Tobago) Oman had the lowest infant mortality rates among these countries. Similar progress was made between 1985 and 1990 in the percentage of students enrolled in primary education[4], which reached 103 per cent in 1990.

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[1] These include, for example, external debt, inflation, growth, public finance and external accounts (Thomas, *et al.*, 1991).

[2] This is the period covered by the Second and Third FYP. And this is the period that coincided with the increase in oil prices in 1981 and their subsequent decline.

[3] Indonesia is regarded as a country that has managed its oil resources well and has also carried out structural adjustment programmes and policy reforms rather successfully (Thomas, *et al.*, 1991).

[4] The data shown in table 5.8 for primary enrolment are based on estimates of children of all ages enrolled in primary education. Therefore, the gross enrolment ratios may exceed 100 per cent because some pupils are younger or older than the country's standard primary school age. Hence, an alternative measure used by the World Bank to capture the effectiveness of the educational system is to estimate the number of children enrolled in the educational system as a percentage of the relevant age group "primary net enrolment" (World Bank, 1993a:p.319).

Table 5.8

Output, health, education and external debt indicators : Oman compared with selected oil exporting developing countries (1980-90)

Country	Growth of output - GDP average annual % growth	Life expectancy at birth (years)		Infant mortality rate (per 1000 live births)		Percentage of age group enrolled in primary education		External debt as a percentage of GNP	
	1980-1990[1]	1985[2]	1990[3]	1980[4]	1990[5]	1985[6]	1990[7]	1985[8]	1990[9]
Oman	8.3	54	66	41	33	89	103	24.1	29.4
Algeria	2.8	61	65	98	67	94	95	24.0	53.1
Ecuador	2.0	58	66	67	55	114	122	60.9	120.6
Indonesia	6.1	55	62	90	61	118	117	32.0	66.4
Mexico	1.0	67	70	51	39	115	112	43.0	42.1
Nigeria	1.6	50	52	99	98	92	72	17.2	110.9
Trinidad and Tobago	-2.5	69	71	35	25	95	95	15.2	50.8
Venezuela	1.1	70	70	36	34	108	92	35.2	71.0
Saudi Arabia	-1.2	62	64	65	65	69	78	-	-

Sources: 1) World Bank (1997b:p.130-132); 2) World Bank (1987:pp.203-204); 3) World Bank (1992:pp.218-219); 4) World Bank (1997a:pp.294-295); 5) World Bank (1992:pp.272-273); 6) World Bank (1988:pp.280-281); 7) World Bank (1993a:pp.294-295); 8) World Bank (1987:pp.238-239); 9) World Bank (1992:pp.265-266) except for Oman from World Bank (1993a:p.285).

These improvements in health and education reflect the policy decisions made by the government to protect these services from cuts in public expenditure. In fact, between 1985 and 1990, expenditure on health as a percentage of central government expenditure increased from 4.2 per cent to 4.6 per cent, and on education it increased from 7.7 per cent to 10.7 per cent respectively. Whereas in the case of Indonesia and Ecuador, expenditure on education went down in the former from 11.3 per cent in 1985 to 8.4 per cent in 1990; and in the latter it declined from 27.7 per cent to 18.2 per cent respectively during the period (World Bank, 1987:pp.246-247 and 1992:pp.238-239).

Moreover, both inflation and external public debt were kept under strict control in Oman. In case of inflation, the GDP implicit deflator[1] registered an average annual decline of 3.6 per cent during the period 1980-90 (World Bank, 1997b:p.207). With regard to public debt, table 5.8 shows that between 1985 and 1990, Oman's external public debt, as a percentage of GNP, increased from 24.1 per cent to 29.4 per cent, whereas, with the exception of Mexico, external public debt for all oil exporting developing countries listed in the above table either doubled or trebled between the two years.

5.10 The Fourth FYP (1991-95) : Reinforcing the Development Process

5.10.1 Objectives of the Fourth FYP : strengthening the planning mechanism

When the Fourth FYP was under preparation, the major part of economic and social infrastructure was already established. Education and health services were made universally accessible and the structure of the output and demand in the economy had by 1990, changed significantly. In addition, the linkages in the economy between oil and other sectors had become stronger and private sector activities had expanded considerably.

Thus, the objectives of the Fourth FYP were formulated in the context of development already achieved, the conditions prevailing in Oman in the late 1980s and the challenges that had to be met in the 1990s. Moreover, in view of the changed situation in the world oil market on account of the Gulf War, the planners in Oman were optimistic in their expectations about the trend of oil prices in the first half of the 1990s.

Special emphasis was also given during the formulation of the Fourth FYP to broaden the participation of different actors in the society, namely the Majlis Ash'Shura, the Chamber of Commerce and other interested parties in the planning process. For the first time, a number of sectoral committees were formed for this purpose. Appendix 3-AI

[1] GDP deflator measures the average annual rate of price change in the economy as a whole (*ibid.*:p.209).

in Chapter III shows that selection and approval of projects were for the first time based on intra-regional and sectoral priorities.

The Development Council identified the following tasks that Oman needed to resolve at the end of the Third FYP: a) to widen the base of the Omani economy and diversify the non-oil sector; b) reduce dependence on oil revenues and strengthen the mechanism set up for managing oil price volatility; c) conserve natural resources; d) expand the participation of Omanis in the labour market; e) enhance the role of the private sector; f) control public current expenditure; and g) achieve a balance between government revenue and expenditure[1] (Oman, 1991a).

The Fourth FYP accorded high priority to raising the level of investment in the economy during 1991-95. The target of total investment for the Fourth FYP period was 42 per cent higher than the investment expenditure incurred during the Third FYP. The ratio of GFCF to GDP was planned to rise to 20.5 per cent in 1995, the last year of the Fourth FYP. The ratio of public investment to GDP was planned to increase to 13.5 per cent compared to 7.5 per cent achieved in 1990, while the ratio of private investment to GDP was expected to rise to 7.0 per cent in 1995 compared to 4.9 per cent recorded in 1990 (cf. table 5.2).

The targets set for the growth of the GDP and its main components were challenging. The target for the average annual growth rate of nominal GDP for the Fourth FYP period was set at 6.3 per cent. The value-added in the petroleum sector was planned to grow at an average annual rate of 5.0 per cent and in the non-oil sector it was planned to grow at an average annual rate of 7.3 per cent. Thus the relative share of the oil sector in GDP was planned to decline to 42 per cent by 1995 compared to 50 per cent recorded

[1] See the Fourth FYP (Oman, 1991a:p.27). These tasks were identified in the Technical Secretariat's 1989 report "The Improvement of Comprehensive Planning Techniques and Objectives Proposed for the Next Phase (1991-2000)" to the Council. The report aimed *inter alia*, at accelerating the pace of structural change and diversification and strengthening the planning methodology and techniques to assist in that process.

in 1990, and the share of the non-oil sector was planned to increase to 58 per cent by 1995 compared to 50 per cent achieved in 1990 (cf. table 5.1).

In view of the high priority given to diversification of the economy, the value-added in the manufacturing and the agriculture and fisheries sectors was planned to grow at an average annual rate of 12.7 per cent and 7.6 per cent respectively, while in the services sector, the targeted average annual growth rate was 6.0 per cent.

The regional dimensions of development were given special emphasis in the Fourth FYP. For this purpose, and departing from past practice, the country was divided into seven planning regions[1]. Moreover, a regional development plan for each region was prepared to guide the selection of investment projects in a manner that was consistent with each region's growth potential, population and area.

To reinforce the institutional mechanism created to deal with volatility in oil prices, a number of measures were adopted. The main ones included raising the rate of transfer to the SGRF to 15 per cent of oil revenues, from the rate of 5 per cent which was applied during the Third FYP; creating a contingency reserve fund[2] to which a certain portion of net oil revenues shall be transferred; and all oil revenues earned beyond the price of US$ 25 per barrel to be transferred to the SGRF[3] (Oman, 1991a:pp.81-82).

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[1] In the previous three plans, the country was divided for planning purposes into three regions. Muscat, Al Janubia, Musandam and other wilayats. In the Fourth Plan, and with availability of statistical data on the growth potential and developmental requirements of each region, and with the evolution of planning experience, the country was divided into seven regions. These seven regions were: Muscat, Al Janubia, Ad Dakhliyah, Ash Sharqiyah, Al Batinah, Adh Dhahira and Musandam. However, in 1991 a new administrative division was carried out by Royal Decree. As a result, the Sultanate was divided into eight administrative regions. These were: Governorate of Muscat, Al Batinah, Governorate of Musandam, Adh Dhahirah, Ad Dakhliyah, Ash Sharqiyah, Al Wusta, and the Governorate of Dhofar (Oman, 1996b:pp.8-17).

[2] 7.5 per cent of net oil revenues — after the transfer to the SGRF — were to be transferred to the fund if the oil price realised was between US$ 18-20 per barrel. This rate of transfer was to be increased to 10 per cent if the price realised was between US$ 20-22 per barrel (Oman, 1991a:p.81).

[3] It was planned that oil revenues earned between the price of US$ 22 and US$ 25 per barrel would be used to expand the level of public expenditure — both current and development (*ibid.*:pp.81-85).

Moreover, the plan froze external public debt at the level outstanding at the end of the Third FYP, which was about RO 1,000 million. However, it was planned to issue development bonds[1] to the extent of RO 429 million during the Fourth FYP to cover part of the fiscal deficit. Thus the level of total public debt, expected to be outstanding on completion of the plan, was set at around RO 1,500 million (*ibid.*).

Among the objectives of the Fourth FYP was to expand the socio-economic data available in the country, through conducting the first national census in 1993. At the same time, it was planned to introduce the concept of rolling plans, whereby the five-year plans would provide on a rolling basis an updated framework of development priorities and programmes, within the context of a 15-20 year perspective (*ibid.*:pp.35-37).

5.10.2 Implementation of the Fourth FYP : further decline of oil prices

The optimism prevailing at the time of formulation of the Fourth FYP, on account of the expectation of a sustained increase in oil prices, was short lived. The oil prices which had increased considerably in 1990 started to decline from 1991 onwards. As a result, the average oil price of US$ 16.5 per barrel realised during the 1991-95, was lower by about 18 per cent than the average price of US$ 20 per barrel, on which the plan forecasts were based (Oman, 1996a:p.22).

Thus, as table 5.1 shows, the growth of the economy at an average annual rate of 2.8 per cent during the Fourth FYP, was lower than the planned growth[2] rate of 6.3 per cent and was even lower than the growth rate of 3.4 per cent realised during the Third FYP. This decline in growth, as table 5.1 indicates, was due to an average annual decline of 2.8 per cent in the petroleum sector during the period compared to a planned annual growth rate of 5.0 per cent. Whereas the growth rate of 7.4 per cent in the non-petroleum activities exceeded slightly the planned growth rate of 7.3 per cent.

[1] This was the first time the government intended to raise money through a domestic bond issue. The main objective behind the idea was to mobilise national savings (*ibid.*:p.128).
[2] All growth rates are average annual rates of growth.

However within the non-petroleum activities, it was the value-added by the non-traded sector of the services that recorded a major increase, because the combined value-added of 9.3 per cent in the manufacturing and agriculture sectors was even lower than their planned target of 9.6 per cent in 1995 (cf. table 5.1). Thus while the Fourth FYP ended with a reduced dependence on the oil sector, it did not see much change in the share of tradable goods sectors of manufacturing and agriculture.

The main casualty of decline in oil prices that we have mentioned and unchecked expansion in current public expenditure was the rate of savings. At the end of the Fourth FYP (1995), the ratio of gross *domestic* savings to GDP was 25.9 per cent compared to 33.9 per cent achieved at the end of the Third FYP period (1990). The ratio of gross *national* savings (GNS) to GDP was even lower at 8.8 per cent in 1995 compared to 23.7 per cent recorded in 1990. The main reason for this was the decline in public savings. The ratio of public savings of 3.6 per cent to GDP was very much lower than the Fourth FYP target of 14.8 per cent and the ratio of 11.4 per cent reached in 1990. The private national savings ratio to GDP in 1995 which stood at 5.4 per cent was similarly much lower than the ratio of 12.5 per cent recorded in 1990, although it was very close to the target of 5.5 per cent for that year.

The steep fall in both public and private savings ratios during the Fourth FYP is reflected in the uncontrolled growth of consumption expenditure which as a percentage of nominal GDP in 1995 reached 74 per cent compared to the plan target of 67 per cent. While the plan target for the ratio of public consumption to GDP was 25 per cent, the actual ratio in 1995 reached 33 per cent (cf. table 5.2).

Thus whilst the Fourth FYP succeeded in substantially enhancing the share of non-oil sector in nominal GDP from 50 per cent in 1990 to 62 per cent in 1995 (cf. table 5.1), it failed to overcome the two main constraints on Oman's growth, viz. declining savings ratio and growing fiscal deficit. Although the government had no control on the international political economy of oil and its subsequent impact on oil revenues, limiting the growth of public expenditure and arrest the decline in national savings, clearly lay within its power.

The plan was successful in meeting the target of GFCF. As table 5.3 shows, actual investment in the public sector was 90.5 per cent of planned investment. In the case of private investment, the ratio of actual to planned was 102 per cent. However at the detailed sectoral level, and as Appendix tables 5-AI and 5-AII show, the performance varied between the public and private sectors and among the different sub-sectors[1].

Confirming the pessimism of the Centre-Periphery school and of the "dependencia" perspective discussed in Chapter II regarding international trade and its impact on development, Oman's terms of trade continued to deteriorate during the Fourth FYP. Because average oil prices during 1991-95 were much lower than even the average prices realised in 1987, while the prices of its imports were on the increase since 1987, Oman's net barter terms of trade index declined in 1995 to 77 (1987 = 100) compared to 1985 when the index stood at 182 (World Bank, 1997a:p.219).

In the case of regional development, the level of investment allocated to each region was generally realised[2], and the aggregate level of implementation was about 90.6

[1] In the case of public investment, the rate of implementation (ratio of actual to planned) in the manufacturing sector was only 17 per cent, in fisheries it was 23 per cent, in vocational training it was 52 per cent and in trade and tourism it was 76 per cent (cf. Appendix table 5-AI). In the private sector, the rate of implementation in these sectors was much higher. For manufacturing it was 72 per cent, fisheries 92 per cent and for trade and tourism it was 98 per cent. The higher levels of implementation achieved by the private sector reflected the increasing confidence of the private sector which has been nurtured by the state through various policy measures.

[2] Compared to the planned level of investment allocated to each region which was: Muscat 18.9 per cent, Al-Batinah 15.4 per cent, Musandam 3.4 per cent, Adh Dhahirah 8.7 per cent, Ad Dakhliyah 8.3 per cent, Ash Sharqiyah 10.3 per cent, Al Wusta 1.6 per cent, Dhofar 8.3 per cent and projects of a general nature about 25.1 per cent of total civil development expenditure, the actual levels for these regions were 18.3 per cent, 14.4 per cent, 3.6 per cent, 8.6 per cent, 13.2 per cent, 8.5 per cent, 1.8 per cent, 8.1 per cent, and 23.5 per cent respectively (Oman, 1996a:p.102).

per cent (Oman, 1996a:p.102). Moreover, as in the previous three five-year plans, considerable progress was also achieved in social development during the Fourth FYP[1].

The goal of formulating rolling plans within a long-term perspective could not be achieved. This was because of lack of technical expertise both at the technical secretariat's level and at the level of operating ministries and departments.

5.10.3 An assessment of the Fourth FYP : the success and failure of planning

The Fourth FYP was successful in a number of areas where planning had an impact. Thus, for instance, the growth of the Omani economy in real terms during 1990-95 at an annual average rate of 6.0 per cent was the third highest among the 17 Upper-middle-income economies and the 11th highest among the 58 Middle-income-economies, while the rate of inflation during the period was the lowest among both of these groups (World Bank, 1997a:pp.216-218, 234-235 and 247).

Similarly the transfers to the SGRF, which were reduced to 5 per cent of gross oil revenues during the Third FYP, were increased to 15 per cent. This was in line with the objectives of the plan to strengthen the government's financial reserves and thus reinforce the institutional mechanism that facilitated the development process.

As a result of a large increase in public investment, the social indicators continued to improve, regional development was enhanced and a number of projects relating to improving the statistical data base such as the national census were carried out.

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[1] In terms of social indicators, life expectancy, for example, further increased between 1990 and 1995 from 66 years to 70 years, infant mortality decreased from 33 per 1,000 live births to 18 during the period, and the percentage of population with access to health care, sanitation and safe water also showed large increases, as we noted in Chapter IV. While the gross primary enrolment ratio, as a percentage of *relevant* age group increased from 52 per cent in 1980 to 85 per cent in 1993, and for secondary the percentage increased from 12 in 1980 to 61 in 1993 (World Bank, 1981 and 1997b).

However, the main failure of the Fourth FYP was the government's inability to control public current expenditure. This in fact confirms Byres (1994:p.532) argument about the Indian planning system, that the problem of planning (in India) was not one of technical capabilities and its functionaries but rather with the nature and levels of decision-making.

Similarly, as we argued in section 3.5.3 of Chapter III, external factors also influence positively or negatively a plan's outcome. Although Oman's planners took precautions in avoiding over-optimistic oil price projections, yet the actual average oil price realised during the Fourth FYP period turned out to be lower than the projected price used in the plan. On the other hand, the price of manufactured imports increased. Hence Oman's terms of trade deteriorated.

Although the government in response to declining oil prices and rising public expenditure took a number of measures during 1993, these were largely ineffective for a number of reasons. These included, for example, the difficulty of reducing current expenditure without causing large scale redundancies in the civil service, the resistance by the various interest groups to increasing the level of fees or taxes imposed by the government, and so on. Again this reflects Byres (1994:p.20) notion of the decline of the relative autonomy of the state as development progresses.

Another negative implication of the expansion of current public expenditure and the consequent increase in the level of final consumption in the economy has been the rise of rent-seeking mentality among the private sector in particular and among Omanis in general. As a result, and as we shall see in Chapter VII, about 69 per cent of the Omani labour force was employed in the public sector. Moreover, only 23 per cent of the expatriate labour was employed in the goods producing sectors, while the rest were employed in construction, and other services like trade restaurants, public administration and so on (cf. table 7.3, Chapter VII).

To address the difficulties faced in sustaining the development process, and in preparation for the Fifth FYP (1996-2000) the government in Oman conducted a number of studies on the economy in 1994. While the study conducted by the World Bank (World Bank, 1994a) recommended a reduction in the role of the state and a number of orthodox, neo-classical policies such as curtailing the role of the government in social and economic services and building up large external reserves, the study conducted by the Omani Ministry of Development took a different approach. As we shall see in Chapter VII, the Omani study[1] took a broader view of the development process. While it emphasised the importance of fiscal discipline and building of financial reserves, it reiterated the important role the state had to play through development planning to accelerate the process of diversification through a stronger public-private partnership. The Omani study also considered human resource development as being one of the main pillars of the New Development Strategy for the 1990s and concluded that this task could not be left to the market alone. The state had to lead the process of development within the framework of the five-year plans.

5.11 Conclusion

In this chapter we have analysed the medium-term objectives, achievements and implementation of the First, Second, Third and Fourth FYPs of Oman. Our analysis indicates that on the whole Oman has been relatively successful in formulating and implementing plans and policies appropriate to its needs and capability prevailing at that time. While the First and Second FYPs were successful in achieving the targets of growth in income and investment, the implementation of Third and Fourth FYP ran into difficulties originating not only from the low level of oil prices and its effects on public revenues but also from declining rates of savings and investment. Some of these problems are endogenous to Oman's development process and are due to shortcomings in policies aimed at dealing with growth in consumption and the government's recurrent expenditure. However, the decline in oil prices and its adverse impact on government revenues is an

[1] This study culminated in the formulation of the 'Vision : 2020', which we discuss in Chapter VII.

outcome of exogenous factors, over which the state in Oman has little influence. In this sense it is suggested in this chapter and in this thesis, that Oman's planning and policies have been important not only for securing development by meeting targets and objectives, but also because in the absence of these, Oman would have experienced great oscillation and even dislocation in its economic and social process. This would have been inevitable given the initial conditions of backwardness prevailing in Oman in 1970 and an extremely volatile primary commodity, oil, which was to finance subsequent development.

We have described the way the government has assumed a prominent role in formulating and implementing development plans from 1976 to 1995. Its direct role was in carrying out a major portion of total investment. Apart from its efforts in raising the level of GFCF, the government has also played an important role which has helped Oman in two ways. First, the government has quickly responded with appropriate policy measures to deal with external shocks, particularly during the Third FYP, which coincided with rapidly declining oil prices. Secondly, the government undertook a number of measures to support and expand private sector activities. This was particularly notable during the Second FYP. Another feature of Oman's development planning is the government's commitment to development planning. When the Omani economy was severely jolted by the collapse of oil prices in 1986, the commitment to implement the plan and its policies was not weakened. In this context the Third FYP targets were revised and new policies to handle changed situations were implemented. The result was that the outcome of Third FYP was better compared to the pessimism prevailing in achieving targets. The same commitment is observable in the preparation of the Fifth FYP based on a shift in strategy to deal with the long-term constraints faced during the Fourth FYP.

A notable feature of our analysis in this chapter is the way that development planning and policy in Oman has had to balance a number of seemingly opposing processes, such as securing high rates of growth and development with focus on capital formation; and on the other continuing to provide sophisticated levels of social welfare and maintaining higher standard of living. The additional complicating factors in this dynamic process have been the uncertainty and volatility of the international oil economy and its impact on the magnitude of revenues accruing to Oman and, secondly changes in international policy, such as in SAPs which influenced policy makers in Oman and its subsequent impact on the country's development.

Thus Oman's relative success in negotiating complex and sometimes very uncertain conditions can be attributed to the commitment of the state to achieving rapid economic and social development in general and through development planning in particular, in a way that state and development planning attempted to do this with varying success in other countries, as we have described in earlier chapters.

Appendix table 5-A1

Comparison of planned and actual public gross fixed capital formation (GFCF) by sectors and sub-sectors (1976-1995)

P = Planned, A = Actual, I = Implementation (ratio of actual to plan)

Sector type	First FYP (1976-1980)			Second FYP (1981-1985)			Third FYP (1986-1990)		
	P^1	A^2	I	P^3	A^3	I	P^4	A^5	I
	RO Mn.	RO Mn.	%	RO Mn.	RO Mn.	%	RO Mn.	RO Mn.	%
1. Crude petroleum activities	88.0	204.7	232.6	559.4	457.6	81.8	544.9	524.5	96.3
2. Natural gas	17.0	20.7	121.8	29.0	38.7	133.4	105.5	74.8	70.9
3. Mining and quarrying	24.3	11.7	48.1	47.2	64.3	136.2	9.9	8.2	82.8
4. Agriculture[a]	26.6	16.8	63.2	46.9	34.0	72.5	30.6	28.7	93.8
5. Fisheries	14.4	5.7	39.6	25.4	9.0	35.4	13.8	14.2	103.2
6. Manufacturing	64.7	6.9	10.7	81.7	76.5	93.6	22.5	26.7	118.7
7. Goods producing sectors (1 to 6)	**235.0**	**266.5**	**113.4**	**789.6**	**680.1**	**86.1**	**727.2**	**677.1**	**93.1**
8. Housing	28.8	28.2	97.9	134.2	98.6	73.5	87.1	70.5	81.0
9. Trade and tourism	11.9	15.2	127.7	69.5	124.2	178.7	57.5	49.1	85.4
10. Electricity and water	123.1	130.3	105.8	186.2	233.8	125.6	198.8	153.5	77.2
11. Posts, telegraphs, telephones[b]	12.4	16.0	129.0	66.8	92.5	138.5	140.7	112.1	79.7
12. Financial institutions[c]	17.0	-	-	-	-	-	-	-	-
13. Transport									
14. Services Sectors (8 to 13)	**193.2**	**189.7**	**98.2**	**456.7**	**549.0**	**120.2**	**484.1**	**385.3**	**79.6**
15. Irrigation and water resources[a]				56.0	46.0	82.1	37.8	26.2	69.4
16. Roads	162.6	192.7	118.5	285.1	281.8	98.8	165.4	150.8	91.2
17. Ports	42.1	43.2	102.6	45.0	15.4	34.2	4.6	1.0	22.5
18. Airports	18.6	22.3	119.9	22.1	17.0	76.9	14.0	10.1	72.2
19. Town planning and municipal services	151.1	38.7	25.6	25.8	111.1	430.6	113.1	100.9	89.2
20. Education	26.1	26.9	103.1	65.2	163.8	251.2	110.6	111.9	101.2
21. Vocational training		7.7		22.9	25.3	110.5	14.4	2.1	14.9
22. Health	33.9	22.1	65.2	34.4	71.7	208.4	126.0	103.3	82.0
23. Information, cultural and religious services	11.6	16.4	141.4	46.1	62.1	134.7	52.7	39.1	74.2
24. Social services[d]	34.1	4.2	12.3	12.7	12.6	99.2	13.8	7.0	50.8
25. Public administration[d]	26.5	355.9	1343.0	99.4	129.2	130.0	413.0	450.2	109.0
26. Infrastructure sectors (15 to 25)	**506.6**	**730.1**	**144.1**	**714.7**	**936.0**	**131.0**	**1065.4**	**1002.8**	**94.1**
27. Total capital formation (7 + 14 + 26)	**934.8**	**1186.3**	**126.9**	**1,961.0**	**2,165.1**	**110.4**	**2276.7**	**2065.2**	**90.7**

Appendix table 5-AI contd...

Sector type	Fourth FYP (1991-1995)			Cumulative of four FYPs (1976-95)				
	P[4]	A[5]	I	P		A		I
	RO Mn.	RO Mn.	%	RO Mn.	%	RO Mn.	%	%
1. Crude petroleum activities	767.4	738.8	96.3	1960	24.6	1926	24.3	98.3
2. Natural gas	114.0	151.1	132.5	266	3.3	285	3.6	107.5
3. Mining and quarrying	13.4	6.8	50.6	95	1.2	91	1.1	96.0
4. Agriculture[a]	27.7	43.1	155.6	132	1.7	123	1.5	93.0
5. Fisheries	32.3	7.5	23.2	86	1.1	36	0.5	42.4
6. Manufacturing	165.9	28.0	16.9	335	4.2	138	1.7	41.2
7. Goods producing sectors (1 to 6)	**1120.7**	**975.2**	**87.0**	**2873**	**36.1**	**2599**	**32.8**	**90.5**
8. Housing	62.7	53.3	85.1	313	3.9	251	3.2	80.1
9. Trade and tourism	24.1	18.2	75.7	163	2.1	207	2.6	126.8
10. Electricity and water	251.1	279.3	111.2	759	9.5	797	10.1	105.0
11. Posts, telegraphs, telephones[b]	127.9	117.6	92.0	348	4.4	338	4.3	97.2
12. Financial institutions[c]	4.0			21	0.3	-	0.0	-
13. Transport	0.1			0	0.0	-	0.0	-
14. Services Sectors (8 to 13)	**469.9**	**468.5**	**99.7**	**1604**	**20.2**	**1593**	**20.1**	**99.3**
15. Irrigation and water resources[a]	69.3	86.7	125.1	163	2.1	159	2.0	97.4
16. Roads	91.0	118.9	130.6	704	8.9	744	9.4	105.7
17. Ports	13.8	20.4	148.0	106	1.3	80	1.0	75.8
18. Airports	12.6	24.4	193.5	67	0.8	74	0.9	109.7
19. Town planning and municipal services	111.4	126.9	113.9	401	5.0	378	4.8	94.1
20. Education	126.0	108.4	86.1	328	4.1	411	5.2	125.3
21. Vocational training	14.8	7.7	52.3	52	0.7	43	0.5	82.1
22. Health	89.8	92.0	102.4	284	3.6	289	3.6	101.8
23. Information, cultural and religious services	45.1	62.7	139.0	156	2.0	180	2.3	115.9
24. Social services[d]	24.6	28.1	114.1	85	1.1	52	0.7	60.9
25. Public administration[d]	588.9	393.0	66.7	1128	14.2	1,328	16.8	117.8
26. Infrastructure sectors (15 to 25)	**1187.3**	**1069.2**	**90.1**	**3474**	**43.7**	**3,738**	**47.1**	**107.6**
27. Total capital formation (7 + 14 + 26)	**2777.9**	**2512.9**	**90.5**	**7951**	**100.0**	**7,930**	**100.0**	**99.7**

Notes:

a) Agriculture in the First FYP includes irrigation.

b) Posts in the First FYP includes transport.

c) Allocations to financial institution although included as part of public investment, were treated as financial investments and hence excluded from GFCF.

d) Comprises public buildings.

Sources: 1) Oman (1976a:p.25); 2) Oman (1986a:p.19); 3) Oman (1986a:pp.22-23); 4) Oman (1991a:p.178); and 5) Oman (1996b:pp.430-431), based on SNA 1993, with detailed sectoral breakdown provided by the Omani Ministry of Development internal data.

Appendix table 5-AII

Comparison of planned and actual private gross fixed capital formation (GFCF) by sectors and sub-sectors (1976-95)

P = Planned, A = Actual, I = Implementation (ratio of actual to plan)

Sector type	First FYP (1976-80)					Second FYP (1981-85)					Third FYP (1986-90)				
	P[1]		A[2]		I	P[3]		A[4]		I	P[4]		A[5]		I
	RO Mn.	%	RO Mn.	%	%	RO Mn.	%	RO Mn.	%	%	RO Mn.	%	RO Mn.	%	%
1. Crude petroleum activities	166	39.5	197	39.9	118.9	545	46.7	577	50.7	105.9	563	55.4	496	60.1	88.1
2. Gas	-	-	0	0.0	0.0	-	-	-	-	-	-	-	0	0.0	0.0
3. Mining and quarrying	-	-	1	0.3	0.0	-	-	-	-	-	-	-	0	0.0	0.0
4. *Agriculture*	16	3.8	13	2.6	81.3	32	2.7	25	2.2	78.1	25	2.5	17	2.0	66.0
5. Fisheries[a]	-	-	-	-	-	*19*	*1.6*	5	0.4	26.3	5	0.5	6	0.8	*124.0*
6. Manufacturing	73	17.4	69	14.0	94.7	235	20.1	100	8.8	42.6	100	9.8	69	8.4	68.9
7. Construction	-	-	4	0.7	0.0	22	1.9	63	5.6	286.3	55	5.4	14	1.8	26.4
8. Goods producing sector (1 to 7)	**255**	**60.7**	**284**	**57.4**	**111.5**	**853**	**73.0**	**770**	**67.7**	**90.3**	**748**	**73.5**	**602**	**73.0**	**80.5**
9. Housing	145	34.5	187	37.8	129.0	262	22.4	283	24.9	108.0	204	20.1	156	18.9	76.2
10. Trade and tourism	20	4.8	11	2.2	55.5	40	3.4	46	4.1	115.0	35	3.4	35	4.3	100.6
11. Electricity and water supply	-	-	0	0.0	0.0	-	-	-	-	0.0	-	-	0	0.0	0.0
13. Communication	-	-	0	0.0	0.0	-	-	-	-	0.0	-	-	0	0.0	0.0
14. Financial institution	-	-	11	2.2	0.0	9	0.8	25	2.2	278.0	20	2.0	16	1.9	78.5
15. Transport	-	-	2	0.3	0.0	5	0.4	13	1.1	260.0	10	1.0	17	2.0	165.0
16. Services sector (9 to 15)	**165**	**39.3**	**211**	**42.6**	**127.7**	**315**	**27.0**	**367**	**32.3**	**116.5**	**269**	**26.5**	**223**	**27.0**	**82.9**
17. Irrigation	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
18. Roads	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
19. Ports	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
20. Airport	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
21. *Municipal services*	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
22. Education	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
23. Vocational training	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
24. Health	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
25. Cultural affairs	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
26. Social services	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
27. Public administration	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
28. Infrastructure sectors (17 to 27)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
29. Total (8+16+28)	**420**	**100.0**	**495**	**100.0**	**117.8**	**1168**	**100.0**	**1137**	**100.0**	**97.3**	**1,017**	**100.0**	**825**	**100.0**	**81.1**

Appendix table 5-AII contd...

Appendix table 5-AII contd...

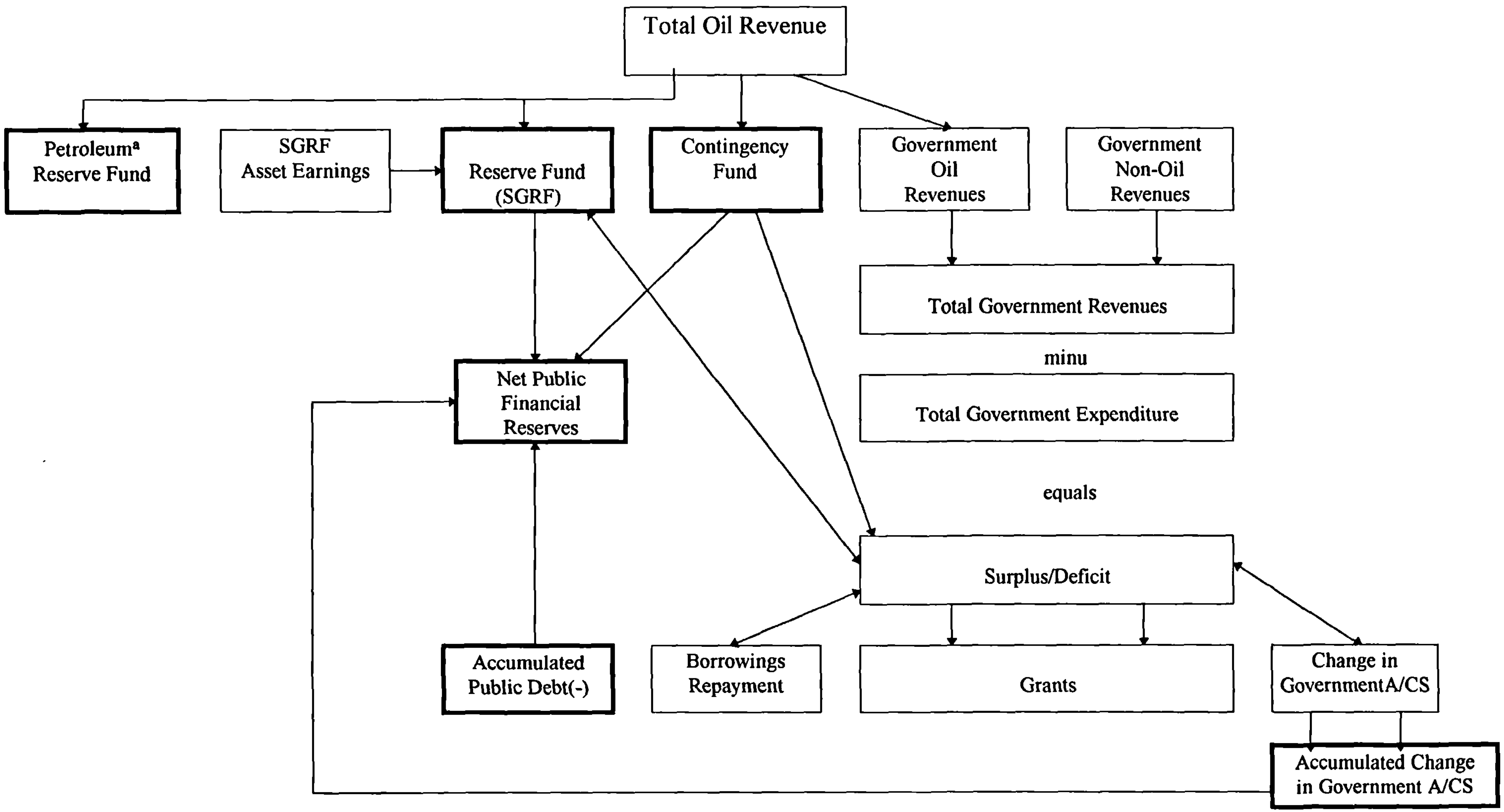
Sector type	Fourth FYP (1991-1995					Cumulative of four FYPs (1976-95)				
	P[4]		A[5]		I	P		A		I
	RO Mn.	%	RO Mn.	%	%	RO Mn.	%	RO Mn.	%	%
1. Crude petroleum activities	608	46.1	619	46.0	101.8	1,882	47.9	1,889	49.6	100.4
2. Gas	-	-	-	-	-	-	-	-	-	-
3. Mining and quarrying	5	0.4	-	-	-	5	0.1	1	0.0	20.0
4. Agriculture	30	2.3	33	2.4	109.7	103	2.6	85	2.2	82.5
5. Fisheries	15	1.1	14	1.0	92.0	39	1.0	28	0.7	71.8
6. Manufacturing	186	14.1	135	10.0	72.4	594	15.1	373	9.8	62.6
7. Construction	103	7.8	21	1.6	21.3	180	4.6	102	2.7	57.8
8. Goods producing sector (1 to 7)	**947**	**71.8**	**822**	**61.1**	**86.8**	**2,803**	**71.4**	**2,478**	**65.2**	**88.5**
9. Housing	230	17.4	395	29.3	171.5	841	21.4	1,021	26.8	121.3
10. Trade and tourism	66	5.0	64	4.8	97.9	161	4.1	156	4.1	97.5
11. Electricity and water supply	-	-	-	-	-	-	-	-	-	
13. Communication	-	-	-	-	0.0	-	-	-	-	
14. Financial institution	38	2.9	29	2.1	76.1	66	1.7	80	2.1	120.9
15. Transport	19	1.4	34	2.6	181.1	34	0.9	66	1.7	194.1
16. Services sector (9 to 15)	**353**	**26.8**	**522**	**38.9**	**148.0**	**1,102**	**28.1**	**1,323**	**34.8**	**120.1**
17. Irrigation	-	-	-	-	-	-	-	-	-	-
18. Roads	-	-	-	-	-	-	-	-	-	-
19. Ports	-	-	-	-	-	-	-	-	-	-
20. Airport	-	-	-	-	-	-	-	-	-	-
21. Municipal services	-	-	-	-	-	-	-	-	-	-
22. Education	5	0.4	-	-	-	5	0.1	-	-	-
23. Vocational training	5	0.4	-	-	-	5	0.1	-	-	-
24. Health	5	0.4	-	-	-	5	0.1	-	-	-
25. Cultural affairs[b]	2	0.2	-	-	-	2	0.1	-	-	-
26. Social services	2	0.2	-	-	-	2	0.1	-	-	-
27. Public administration	-	-	-	-	-	-	-	-	-	-
28. Infrastructure sectors (17 to 27)	**19**	**1.4**	-	-	-	**19**	**0.5**	-	-	-
29. Total (8+16+28)	**1,319**	**100.0**	**1344**	**100.0**	**101.9**	**3,924**	**100.0**	**3,801**	**100.0**	**96.9**

Note: a) Fisheries included in agriculture in the First FYP; b) Cultural affairs include information and religious affairs.

Sources: 1) Oman (1976a:p.25); 2) Oman (1986a:p.19); 3) Oman (1986a:pp.30-31); 4) Oman (1991a:p.178); 5) Oman (1996b:pp.430-431), based on SNA 1993 and detailed sectoral breakdown obtained from the Omani Ministry of Development internal data.

Appendix - chart 5-AI

Simplified structure of financial stocks and flows



Flow variables   Stock variables

Note: a) Until end of 1996, the assets of this Reserve Fund had not been integrated into the Government's Accounts.

Source: Compiled from Oman (1981a; 1991a and 1996a).

CHAPTER VI

THE STATE AND MARKET IN OMAN'S DEVELOPMENT

6.1 Introduction

In this chapter we assess the role of the market in Oman's development. This is done by examining the activities of the private sector in the economy. We also describe the way the state, through a series of FYPs, has fostered the market and the private sector. This analysis will enable us to assess the relationship between the state and market and the contribution of the latter to Oman's development.

This chapter shows that the planners and policy makers in Oman considered the roles of the state and markets as complementary and not mutually exclusive and competitive. Although the state itself is a major entrepreneur, it has assumed this role without discouraging or displacing private enterprise[1]. In fact, without the state's encouragement the private sector and markets would be extremely weak in Oman. Put another way, this chapter concretises systematically the assertions made in this research that the state has fostered the private sector and the market in Oman. This is illustrated by, among other things, the increased role and importance of the private sector in Oman's economic activity. Of course, some aspects of the private sector's role in Oman's development have been described in the previous chapters, especially Chapters IV and V. There, among other things, the role of the private sector in gross capital formation was analysed.

[1] In this respect, Oman stands out in contrast to the mixed economy of India where during the first two decades of planning (1951-71), the state discouraged entry of private sector in heavy industries, notably steel and displaced private (foreign) firms in petroleum (See Chakravarty, 1987:Chapters 1 and 2).

6.2 Basic Approach towards Market and Planning in Oman

The Development Council's resolution dated 09/2/1975 on "Aims and Objectives of Economic Development Policy in the Sultanate" (Oman, 1976a:p.107) explicitly states the Omani government's intention and commitment to combine the merits of state sponsored planning and the market system for promoting economic development[1]. The following quotation from that resolution clearly brings out the policy perspective of Oman's development strategy.

> [T]he basis of our development policy should be to achieve the basic requirements of a *free economy* in which an efficient and capable private sector plays a leading role ... [T]o achieve this aim the government has undertaken the execution of supporting infrastructure projects, decided on incentives in the form of exemptions from customs duties, granted loans with easy repayment terms to productive projects, and participated in the capital of some vital projects within available government resources ... [T]he plan must aim at maintaining and developing the prevailing economic activities by giving them support and encouragement particularly in the sector of agriculture and fisheries ... [I]t is important to encourage domestic trade activities by finding suitable solutions to the problems of transportation and storage and other obstacles which block the way to reach the state of perfect market (Oman, 1976a:pp.106-109).

[1] The text of this resolution is reproduced in Appendix C of *The First Five-Year Development Plan*, 1976-80 (Oman, 1976a).

6.3 Role of the State in Promoting the Market in Oman

With its control over the oil revenues, the state, through the FYPs, performs the tasks it is most suited to perform; whist the private sector undertakes activities for which it is most suited under the promotional policies of the state. Following this simple rule of division of labour — specialising in the job which one is most suited to perform — the functions that the state performs in Oman are reflected in the pattern of activities and investment undertaken by the government under the successive plans. The major functions performed by the state in Oman over the last 20 years to promote a competitive and efficient private sector are discussed below.

6.3.1 Macroeconomic management and economic stability

The two most important areas of macroeconomic management which influence private sector activity are related to the government's budgetary position with its implications for price stability and the exchange rate management. Although there is no convincing theoretical case for a balanced budget, and the desired level of budget deficit or surplus will depend on a range of factors[1], sound policy requires, as Weiss (1995) indicates, that deficits are not so high as to stimulate inflation, depress private investment[2] or create unsustainable external debt. "On the other hand, they should not be so low as to hold back growth through their depressing effect on domestic demand (*ibid.*:pp.9-10).

In Oman, the government has used the FYPs as means to ensure appropriate economic management. Although budget deficits have been large in recent years[3], they have not generated inflation. Over the period 1985-95, for example, average annual inflation rate, as represented by the GDP deflator, was -3.6 per cent, and during the

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[1] These include, for example, the extent of unemployed resources in the economy, the returns on marginal government investment, the cost associated with deficit financing and the availability of foreign exchange reserves.

[2]Through the 'crowding out' effect, by *raising the cost of borrowing* for the private sector.

[3] Average annual fiscal deficits increased to about 10 per cent of GDP during 1991-95 compared to about 5 per cent of GDP during 1976-80 (Oman, 1996b).

period 1990-95, the average annual rate was -2.9 per cent (World Bank, 1997b:p.207). And since these deficits were to a large extent financed through withdrawals from the reserve funds (SGRF) created in 1980, it was unnecessary to finance these through money creation, and thus harm prospects for economic growth. Neither have they resulted in 'crowding out' of private investment through excessive domestic borrowings, nor have the deficits been funded through large external borrowings[1].

6.3.2 Provision of physical infrastructure

Physical infrastructural services — power, transport, roads, telecommunication, water and so on — are not only important consumption goods (as with clean water and electricity for households) but also provide vital inputs in the production process. Therefore, the quality and adequacy of infrastructure are important determinants of the success of firms in delivering products and services of high quality, at competitive prices and in the shortest possible time. This is in line with our discussion in Chapter II, about the need for a minimum size of investment in each infrastructure project for the provision of social overhead capital, because such a provision creates investment opportunities in other industries. Moreover, as Rosenstein-Rodan (1943 and 1984) argues, the supply of this minimum is beyond the capacity of individual entrepreneurs.

Therefore, to facilitate private sector activities and improve the market mechanism, the government since the mid 1970s has embarked upon an ambitious programme of physical infrastructure development. Out of a total cumulative public investment of RO 7.9 billion undertaken during the period 1976-95, investment in social and economic infrastructure[2] amounted to RO 3.7 billion, representing a share of almost 47 per cent (cf. table 5.3 and 5.4 of Chapter V). In view of the large size of the country, and in order to promote small and informal enterprises particularly in rural areas, and to create linkages

[1] Oman's total public debt of RO 1,500 million is relatively low compared to its GDP. At the end of 1995, Oman's external debt of 29.5 per cent as a percentage of its GNP was much lower than that of most of the Upper-middle-income countries (World Bank, 1997a:p.247).

[2] This includes investment in roads, ports, airports, municipal services, public administration, health, and education.

within the domestic market, 20 per cent of the total amount invested in infrastructure has been spent on constructing a wide network of roads throughout the country.

Emphasising the importance of transport infrastructure, the 1997 World Development Indicators (1997b:p.279) states "[p]roviding the infrastructure for transportation to meet the demands of a modern economy is one of the major challenges of economic development". Comparing the level of transport and infrastructure with other countries, we find, for example, that the 'normalised road index[1]' in Oman in 1995 was 211 compared to 118 in South Korea, 38 in Indonesia and 140 in Thailand (*ibid.*:pp.277-279).

6.3.3 Development of human resources

One of the main elements of Oman's long-term development strategy has been the development of its human resources. Human resources are both the means through which development is achieved and the ultimate objective of development. Moreover, well-developed human resources are the key to long-term competitiveness, and only by investing in human resources can countries create new and dynamic competitive advantages. As the World Bank report on Private Sector Development indicates, "the link between literacy and productivity improvements is strong and experience has demonstrated the difficulty of imparting information about technologies, markets, and so on to an illiterate population" (World Bank, 1995c:p.44). To achieve this goal, the government in Oman has undertaken the task of building a country-wide network of social infrastructure in the form of educational and vocational training institutes; health care organisations like hospitals and clinics; and cultural and social centres.

[1] Normalised road index is the total length of roads in a country compared with the expected length of roads, where the expectation is conditioned on population density, per capita income, urbanisation, and region-specific dummy variables. A value of 100 is "normal". If the index is more than 100, the country's stock of road exceeds the average (*ibid.*).

Therefore, commitment to human development in Oman's development strategy has been very strong. Oman's record of progress in this respect is highlighted by the 1997 *Human Development Report*, which states:

> Beginning in 1970, Oman undertook a comprehensive programme of human development, achieving some of the most rapid advances ever recorded. Life expectancy has increased by 30 years, from 40 years in 1970 to 70 years in 1994 ... [I]mprovements in education have been even more impressive ... [I]mprovements in health and education have been accompanied by rapid advances in other areas of human development (UNDP, 1997:p.28).

As we shall see in Chapter VII, enhancing human resource development, in order to equip all Omanis with the necessary skills and abilities to cope with the challenges posed by globalisation is one of the main elements of Oman's New Development Strategy.

6.3.4 Government support to agriculture and fisheries[1]

Since the 1970s Oman's development strategy has continued to support the dominant role of the private sector in the agriculture and fisheries sectors. The government has through successive FYPs initiated a variety of projects, such as fishing harbours, boat repair facilities, water dams and irrigation systems to develop this sector. The government also provides a range of subsidised inputs in the form of veterinary services, seeds, fertilisers, fishing boats and nets, and so on, through its current budget. During the Second FYP, for example, the Government established the Agriculture and Fisheries Bank[2] to provide medium-term finance to this sector at subsidised interest rates.

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[1] Chapter V provides details of the various types of support provided to this sector.

[2] The Development Bank of Oman was formed in March 1997 to take over the functions of both the Agriculture and Fisheries Bank and the Oman Development Bank. The new bank will continue to provide subsidised finance to the private sector at rate of interest not exceeding 3 per cent per annum. The bank will extend medium-term finance for manufacturing, agriculture, fisheries, non-oil mining, health, education and handicraft activities (Oman, 1997:Decree no. 18/97).

Though the traditional nature of this sector (it may be considered to constitute the informal sector) makes it difficult to assess the magnitude of private sector investment in it, available data indicate that total private sector investment over the previous two decades amounted to RO 113 million. Excluding the private sector's investment in the oil and gas sector, this represented about 6 per cent of total private sector investment in the economy over the period 1976-95 (cf. Appendix table 5-AII of Chapter V).

Similarly, during the Second FYP, the government set up the Public Authority for Marketing of Agriculture Produce (PAMAP) to facilitate the collection, distribution and marketing of agriculture produce. This was done because the existing marketing channels were unable to provide these services throughout the country. Thus the government support to this sector of the economy, which is owned and managed entirely by the private sector, has led to an increase in its value-added of more than 7 times, from RO 18 million in 1976 (Oman, 1986b:pp.396-404) to RO 152 million in 1995 (Oman, 1996b:pp.380-385). As a result, this sector's share in GDP has grown from 2.1 per cent in 1976 to 2.9 per cent in 1995 (*ibid.*).

Unlike many developing countries, where the agricultural sector suffered from discrimination in the provision of subsidised credit, social infrastructure and public services (Myint, 1987:p.124), in Oman the development policy has treated both the traditional agriculture sector and the modern manufacturing sector evenly in this respect. However, perhaps a major shortcoming of Oman's development policy has been the lack of protection provided to the agricultural and fisheries sector. While the modern manufacturing sector has been provided with custom duty protection[1] from competing imports, this has not been the case with the agriculture sector[2]. Even the mean tariff of about 5.7 per cent (World Bank, 1997a:p.253) applicable to almost all imports, does not apply to food imports, which remain exempt. Although such a policy keeps food prices low, it works against the development of the agriculture sector.

[1] Although, as we have mentioned in Chapter IV, this has also been limited.

[2] Agriculture sector also includes fisheries, unless otherwise indicated.

6.3.5 Government as entrepreneur

Oman has had a long and well established tradition of private entrepreneurship in agriculture, fisheries and trade. However, it has faced a shortage of entrepreneurial skills in the management of organised business in the modern 'formal' economy. Therefore, the Omanis need training and assistance to be able to participate fully in the ownership and management of diversified businesses. Recent efforts on the part of the government are a pointer in this direction. For example, the government's Omanisation policy both at the sector and individual unit levels attempts to fill this gap by promoting the development of indigenous entrepreneurship.

Since the private sector in Oman was relatively weak and modern industry was almost non-existent till the 1970s, the government had to play the role of the Schumpeterian pioneering entrepreneur. This was, as we discussed in Chapter II, due to the externalities and indivisibilities of large investment projects and the need to create backward and forward linkages (Hirschman, 1958) in the economy through either a balanced or an unbalanced growth strategy[1]. The government was, therefore, instrumental in the setting up of a number of public enterprises with the intention of "crowding in" private sector investment and enhance the efficiency of the working of the markets.

For example, the government entered into a partnership with the private sector in setting up in 1977 the first national insurance company[2] to provide general and life insurance services. Similarly, the Oman Cement Company was set up as a public-private joint venture to overcome the extreme shortage of cement in the 1970s that was

[1] Although, as we discussed in Chapter II, there were neo-classical economists such as Bauer, who opposed such a role for the government. Bauer believed, for example, that a developed infrastructure was not a precondition for growth, "[I]t is unhistorical to envisage an elaborate and expensive infrastructure as a necessary ground-work for economic advance". And that economic development was to a large measure due to "individual voluntary responses of millions of people to ... opportunities created largely by external contacts and brought to their notice ... primarily through the operation of the market" (Bauer, 1984:pp.30-31).

[2] Oman National Insurance Company was set up in 1977, with the government owning 15 per cent of its capital.

frustrating both public and private sector investments; and the Port Services Corporation was set up as a joint venture with the private sector to manage the main port — Port Sultan Qaboos — which was facing serious management problems in the 1970s. In fact most of the state-owned enterprises were set up to overcome supply bottlenecks and entrepreneurial scarcity or to improve market and managerial efficiency.

6.3.5.1 Performance of state-owned enterprises (SOEs)

One of the grounds on which the IFIs and neo-classicals have advocated "rolling back" the state in the developing countries is that SOEs are generally considered to be loss-making and on many counts are less efficient compared to privately-owned enterprises (POEs) [1]. To show that this is not the case in Oman we briefly examine the financial performance of SOEs in Oman and compare this with the performance of POEs. It is important to do so, because, as we shall see in Chapter VII, one of the dilemmas of privatisation in Oman is that it would lead to loss of government revenues as a majority of SOEs make good profits.

Moreover, a number of empirical studies[2] show that in many LDCs including Oman, the SOEs have pioneered a whole range of new industries and induced private investment in the initial phase of development.

There are at present 25 SOEs in Oman and as table 6.1 indicates, these include wholly owned government companies, public authorities, companies in which the government owns a majority interest and companies in which the government holds less than 51 per cent but has a significant management role. State-owned public utilities like

[1] As we have noted in Chapter I, the IFIs (World Bank, 1987) and the neo-classical economists advocate "rolling back" the over-extended public sector in developing countries because they argue that SOEs have been inefficient, over-centralised, loss making and poor performers on various other counts. It is also argued that they have not even succeeded in playing the strategic role in industrialisation that government had hoped for. Thus it is suggested (Roth, 1987; Biersteker, 1992) that privatisation of these SOEs will improve efficiency, reduce total public outlays on services presently provided by the state and promote private sector development through encouragement of foreign investment and preventing the state from "crowding out" the private sector from the capital and financial markets.

[2] For example, Hazari (1969); Wade (1990); and Petri (1993).

water and electricity services are run as departments of the Ministry of Electricity and Water, and although prices are charged for these services, their revenues and expenditures are included in the public revenues and public expenditure and form part of the general *state budget*

As table 6.1 shows, out of the 17 SOEs for which financial data for the last three years (1993, 1994 and 1995) are available, the return on share capital invested was negative for only six SOEs in 1995 and of these, it was negative for 3 SOEs in all three years. Thus in 1995, 11 out of 17 SOEs (i.e. 65 per cent) were profit-making, earning positive return on government investment in their share capital.

Examining the financial performance of these 17 SOEs, table 6.1 shows that on average the SOEs are performing well in comparison with the average performance of about 100 companies listed on MSM[1] (Muscat Securities Market) all of which are private, except the 6 listed SOEs. In the last three years (1993-95), the average annual return earned by these SOEs has varied between 16 per cent to 21 per cent whereas the average annual return for the companies listed on the MSM has varied between 16 per cent to 24 per cent. If one considers that the average cost of domestic government borrowing does not exceed 8 per cent per annum, the average return of 16 to 21 per cent earned by the SOEs is much higher than the cost of funding.

[1] They include 6 SOEs listed on the MSM.

Table 6.1

State-owned enterprises and their financial performance 1993-1995

Enterprises	Year of establish-ment	Govt. holding in share capital[1] (%)	Return on share capital (%)		
			1993	1994	1995
A. Companies listed on MSM					
01. Oman Cement Company SAOG	1977	63.5	28.4	19.9	25.7
02. Oman Flour Mills Co. SAOG	1975	59.9	51.6	59.2	53.7
03. Oman Development Bank SAOG	1977	54.2	18.7	6.0	8.9
04. Port Services Corporation SAOG	1975	35.5	21.2	4.8	1.2
05. Oman Aviation Services Co. SAOG	1981	33.9	42.4	38.3	35.0
06. Oman Fisheries Co. SAOG	1989	24.0	19.8	21.8	17.9
B. Non-listed companies					
01. Salalah Hotels Co. SAOC	1978	100.0	33.2	7.2	2.0
02. Oman Bank for Agriculture & Fisheries SAOC	1981	100.0	(4.6)[3]	(3.0)	1.0
03. Oman National Transport SAOC	1978	99.9	0.8	(3.1)	(1.0)
04.Oman Mining Co. LLC.	1976	99.8	(4.4)	(9.0)	(9.2)
05. Oman Refinery Co. LLC.	1983	98.3	105.3	86.3	150.5
06. Oman Housing Bank SAOC	1976	60.9	7.8	7.5	8.1
07. Petroleum Development Oman[2]	1974	60.0			
C. Public authorities (with specified capital)					
01. General Telecommunications Organisation	1975	100.0	44.2	52.7	72.2
02. Public Authority for Marketing of Agriculture Produce (PAMAP)	1985	100.0	(4.7)	(4.7)	(3.1)
03. Public Authority for Storage & Food Reserves	1980	100.0	(5.6)	(3.2)	(6.2)
04. Oman Advertising Agency	1986	100.0	2.2	2.2	(2.0)
05. Oman Newspaper House	1980	100.0	12.9	0.5	(9.4)
06. Central Bank of Oman[4]	1975	100.0			
D. Public enterprises with un-specified capital[5]					
01. Al Bustan Palace Hotel	1985	100.0			
02. Muscat Intercontinental Hotel	1987	100.0			
03. Seeb Novotel	1982	100.0			
04. Oman International Exhibition Centre	-	100.0			
05. Al-Inshirah Restaurant	1987	100.0			
06. Khasab Hotel	-	100.0			
Overall average return for all SOEs			**20.8**	**15.9**	**19.3**
MSM average return			**16.0**	**20.3**	**23.5**

Notes:

1) Share capital means the equity capital invested by the shareholders
2) Petroleum Development of Oman operates as a non-trading oil producing company. All costs of its operations are funded by its shareholders in proportion to their shareholdings. While all oil produced by it is sold directly by its shareholders, in proportion to their shareholdings, and thus all sale proceeds accrue to them.
3) Negative returns are shown in brackets.
4) Central Bank of Oman (CBO) is excluded from this analysis because of its non-commercial nature and also to avoid any distortions in our analysis because of the large profits earned by the CBO in relation to its capital.
5) Returns for these enterprises are not calculated because they are not organised as independent legal enterprises, neither is their capital specified. However, most of these are managed professionally under contract, by international hotel chains.

Sources: Financial returns of SOEs are calculated from published reports and internal data supplied by the Ministry of Finance. MSM averages are compiled from MSM *Monthly Statistical Bulletin*, December 1993-1996.

Petroleum Development (Oman) Ltd., being one of the 25 SOEs listed in table 6.1, presents an important case of public-private co-operation. PDO has been the vehicle through which state of the art technology, modern management methods and foreign investment have been introduced in Oman's oil sector. The ability of the state to generate additional resources from the oil sector has provided it the autonomy required to realise the nation's socio-economic goals. The state in Oman has been able to create significant "fiscal linkages" between oil and the rest of the economy, which as Hirschman (1981) suggests are analogous to the "backward" and "forward" linkages created by other industries. These resources have enabled the state in Oman to provide 'basic goods' to its people at affordable prices.

6.3.6. Role of the state in developing the market

In addition to investing wholly or in partnership with the private sector in specific industrial projects like refinery, copper smelting, cement manufacturing etc., the state in Oman initiated a number of policies through successive FYPs to develop and stimulate the market.

First, the Oman Development Bank[1] was established to provide or guarantee medium- and long-term loans to private projects in manufacturing, agriculture, petroleum, mining and fisheries. Among the terms of reference of this bank was to provide technical assistance to the private sector and participate in the equity capital of private enterprises (Oman, 1976a).

Second, the continued emphasis on provision of soft finance and infrastructural support to the agriculture and fisheries sector, as we noted in section 6.3.4.

[1] This bank was dissolved in 1997 and a new bank "The Development Bank of Oman" was formed.

Third, the setting-up of industrial estates, in addition to providing a number of incentives[1] for the development of private industry. Because: "The construction of an industrial area is of vital importance to the development of Omani industry. The construction of an industrial area would also help to protect other areas from industrial pollution" (*ibid.*:p.47).

Fourth, to stimulate and facilitate private investment in the goods producing activities of agriculture, fisheries, manufacturing, mining and handicrafts, a programme of providing long-term interest free loans to the private sector, in addition to the soft loans provided by the specialised banks[2], was adopted within the Second FYP:

> The grants and loans programme represents a substantial stimulus to the private sector enterprises. It was possible for the government to direct these funds to the creation of government-owned projects in these sectors as an alternative. However, this would not have helped to achieve a major objective of the economic development strategy of Oman, namely *the creation of an economy based on private enterprise* (Oman, 1981a:p.46) (emphasis added by the present author).

Fifth, a Council for Agriculture, Fisheries and Industry was set up in 1979 to foster public-private partnership in these sectors[3]. The objectives of the Council included *inter*

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[1] These include a certain level of tariff protection, provision of soft finance, preferential treatment in government contracts to locally produced goods (Oman, 1976a:p.47).

[2] Specialised banks refer to the three banks set up by the government to provide subsidised medium- and long-term finance to the private sector and Omani households. These are: Oman Housing Bank, Oman Development Bank and Oman Bank for Agriculture and Fisheries (Oman, 1981a:p.47). The last two were merged in 1997 to form the Development Bank of Oman.

[3] The Chairman of the Chamber of Commerce and Industry was appointed as President of the Council, with the Undersecretaries of the Ministries of Agriculture and Fisheries and Commerce and Industry as *ex-officio* members. In addition there were nine other members from the private sector. This council was dissolved in 1981 when a wider form of public representation was introduced through the setting-up of the first State Consultative Council in the same year (Oman, 1995c:Decree no.81/84).

alia: to ensure the rapid growth of the three sectors, agriculture, fisheries and industry; to enhance and support the role of national private enterprise; to eliminate the factors preventing good administrative practice in government and monopolistic practices in the private sector; and to ensure the participation of citizens in deciding on the ways and means to achieve these objectives.

Sixth, continuing the support given to private sector development, the Fourth FYP adopted a number of policies and measures which aimed to support the private sector and strengthen the market mechanisms. These included: motivating the private sector to invest in areas which have been the government's domain such as power projects[1], toll roads, mining and health projects; provision of short-term finance and export insurance for Omani exports; issue of development bonds to mobilise private savings; gradual privatisation of government owned enterprises; stimulating the MSM so that it can play a more active role in financial intermediation and in encouraging small investors to invest in companies listed on the market; and providing support for the establishment of a business school by the Omani Chamber of Commerce to create, *inter alia*, a generation of entrepreneurs able to participate increasingly in the production and development processes (Oman, 1991a:pp.127-129).

6.4 Role of the Private Sector in Oman's Economy

As a result of the policies and measures implemented during the four FYPs, the role of the private sector has in general evolved in accordance with the growth of the economy. Although the ratio of private sector investment to GDP has remained constant at around 6 per cent, this has been achieved within an expanded GDP[2]. Moreover, as table 6.2 shows, the relative share of the private sector in GFCF has also been increasing,

[1] The Manah project was the first private sector project set up in 1992 for generating electricity and selling the output to the government (Oman, 1991a:p.128). In fact, the Fourth FYP introduced the concept of privatisation which is discussed in Chapter VII.

[2] Oman's nominal GDP (at market prices) has grown from RO 884 million in 1976 to RO 5,288 million in 1995 (Oman, 1986b and 1996b).

reflecting the government's strategy of encouraging the private sector to take an active role in the development process. While the private sector's share of total GFCF was 23.8 per cent in the pre-plan period 1971-75, it rose to 28.3 per cent in the First FYP. And in spite of fluctuations between 1981 and 1990, its share reached 34.7 per cent during 1991-1995.

Table 6.2

Private sector's share in gross fixed capital formation (GFCF) 1970-95

Plan	Plan period	Annual average for each plan period		
		GFCF RO Mn.	As % of GDP	As % of total GFCF
Pre-plan	1971-1975	25	7.1	23.8
I	1976-1980	99	5.7	28.3
II	1981-1985	159	4.8	21.7
III	1986-1990	165	4.6	28.5
IV	1991-1995	269	5.6	34.7

Source: Compiled from *Statistical Year Book 1975; 1985; 1995* (Oman, 1976b:p.122; and 1986b:p.429 for pre-plan and First FYP and 1996b:pp.430-431 for Second, Third and Fourth FYPs).

While a number of industrial, tourism, and commercial projects were set up by the government in the early phases of development either solely or in partnership with the private sector, no similar projects were set up, for example, in the Third and Fourth FYPs. Moreover, although SOEs that were formed for owning and managing these projects are presently profitable, the government in line with its New Development Strategy, intends to privatise them within an appropriate time-frame, thus expanding and strengthening the private sector further.

As table 6.3 indicates, the areas in which the private sector has a comparative advantage remain entirely private. Thus agriculture, fisheries, construction, internal and external trade (with the exception of oil trade), real estate, financial intermediation and business services are almost entirely owned and managed by the private sector. Even in manufacturing, the private sector is dominant with the exception of certain capital intensive industries which were set up for reasons mentioned earlier.

Table 6.3

Estimated relative contribution of the private sector in the value-added in the GDP at current prices (1976 and 1995)

(per cent)

Economic activity : value-added	1976 Share in GDP	1976 Relative contribution of the private sector	1976 Private sector's share in the GDP	1995 Share in GDP	1995 Relative contribution of the private sector	1995 Private sector's share in the GDP
1. Total petroleum sector[a]	**58.5**	**40.0**	**23.4**	**38.2**	**40.0**	**15.3**
2. Total non-oil sector[b]	**41.0**	**44.3**	**18.2**	**60.9**	**55.5**	**33.8**
2.1 Agriculture	1.4	100.0	1.4	1.9	100.0	1.9
2.2 Fisheries	0.7	100.0	0.7	1.0	100.0	1.0
2.3 Mining and quarrying	-	-	-	0.3	-	-
2.4 Manufacturing [b]	0.5	80.0	0.4	4.6	80.0	3.7
2.5 Electricity and water	0.7	-	-	0.9	-	-
2.6 Construction	10.0	100.0	10.0	2.6	100.0	2.6
2.7 Trade, hotels and restaurants	8.7	60.0	5.2	13.5	80.0	10.8
2.8 Transport and communication	1.5	50.0	0.8	6.3	50.0	3.2
2.9 Financial intermediation[c]	0.1	80.0	-	0.4	90.0	0.4
2.10 Real estate, business, and other services	9.2	100.0	9.2	7.9	100.0	7.9
2.11 Public administration	6.7	-	-	13.3	-	-
2.12 Education[d]	0.6	-	-	4.2	-	-
2.13 Health[d]	0.4	-	-	1.7	-	-
2.14 Other services	0.5	100.0	0.5	2.3	100.0	2.3
3. Plus: Import duties	**0.5**		-	**0.9**	-	
4. Total GDP at market prices (1 + 2 + 3)	**100.0**		**41.6**	**100.0**		**49.1**

Notes:

a) Because there are foreign shareholders to the extent of 40 per cent in PDO, the main oil producing company in Oman, private sector's share has, therefore, been estimated at 40 per cent of the oil-GDP. Moreover, the oil sector is run like any other private enterprise in terms of commercial discipline, management systems, and decision making.

b) For manufacturing sector value-added by public and private are not available. Hence it is assumed that about 80 per cent of value-added in this sector is by industries in which private sector is predominant.

c) This figure is net of imputed financial charges. At a gross level, this sector's contribution was 1.27 per cent in 1976 and 2.9 per cent in 1995.

d) Although there are quite a few private schools and clinics, their relative contribution is still very small.

Source: Estimates compiled from *Statistical Year Book 1985; 1995* (Oman, 1986b:pp.402-404 and 1996b:p.384).

Despite the private sector's apparent success in participating actively in the development of Oman's economy, the state in Oman intends to further strengthen this role. The New Development Strategy and Policy, which we shall discuss in Chapter VII, envisages the private sector taking an even larger role in the economy within the framework of the plan and market working in co-operation with and under the state's overall guidance.

6.4.1 The complementary nature of public and private investment

The fact that in Oman the areas of economic activity of the state and the private sector are not conflicting but complementary is also clearly brought out by the patterns of public and private investment in the four FYPs. We thus find, from table 5.3 in Chapter V, while investment in infrastructure sector which has continued to remain entirely within the domain of the public sector, the private sector's share in the total investment in goods producing and services sectors was nearly equal to that of public sector. Its share of investment in goods producing sector was about 49 per cent, while its share in services sector investment was around 46 per cent during the period 1976-95. However, the sectoral distribution of public and private investments differ significantly. As table 5.4 in Chapter V indicates, almost half of private investment is in the oil sector and this is contributed solely by way of foreign direct investment by the oil multinationals. About 27 per cent of private investment is in the housing sector. Of the remaining 23 per cent, 9.8 per cent is in manufacturing, 2.9 per cent in agriculture and fisheries, 2.7 per cent in construction, 2.1 per cent in financial institutions and 5.8 per cent in trade, tourism and transport. In contrast, 47 per cent of public investment is in economic and social infrastructure where private investment is conspicuous by its absence. The share of oil sector in government investment is relatively small at 24.3 per cent which perhaps reflects the government policy of building a strong partnership with the foreign private sector to develop this strategic national resource, and also provide a substantial part of the funding required for that purpose.

An important aspect of the patterns of distribution of public and private investment is the complementary nature of these investments. Thus, apart from oil and gas, where the public and private sectors have developed a strong partnership, government's investment in agriculture, fisheries and manufacturing has been mainly in developing a supportive physical infrastructure for facilitating private sector activity.

In the case of housing, while the government had to build public housing for the civil servants in the initial stages of development because no private alternative was available, this practice was replaced in the early 1980s when the government started paying allowances in lieu of housing. Similarly in the initial stages, the government provided low cost housing to the weaker sections of the society but in the Fourth FYP this policy was discontinued. Instead, housing grants are being provided to people living on social security and interest free loans are provided to low-income groups. Signalling the shift in policy, the Fourth FYP stated:

> [E]ncourage and support the role of the private sector and enhance its participation in the housing sector and restrict the government role to planning ... and developing the appropriate organisational, institutional and legislative framework. Provide appropriate means of finance for the private sector and individuals and restrict housing projects to specific items which are needed to implement these projects (*ibid.*:p.206).

Only in trade and tourism is the state being seen as competing with the private sector. But here, too, the state had to invest in up-market hotels largely due to the same arguments of market failure and scarcity of private capital, which we have discussed in Chapters II and III. Nevertheless, all state-owned hotels are managed under contract by private hotel management companies. Overall, the patterns of public and private investment have been mutually reinforcing.

6.5 Legal and Regulatory Framework for Private Business

One of the most important elements that foster private sector activities is the availability of a legal and regulatory framework. In this connection, the government has enacted a number of laws. These include: the Commercial Register Law and the Commercial Companies Law of 1974 and their subsequent amendments. The former aims to provide an official registration system for all business and commercial activities conducted by merchants, commercial companies, branches and agencies of foreign companies in Oman, while the latter law governs the formation of commercial companies. According to the articles of this law, private business activities in Oman can be organised in any of the following six legal entities: individual proprietorship, a general partnership, a limited partnership, a joint stock company (approximately equivalent to a public limited company in UK or in India) a limited liability company (LLC) (approximately a private limited company in UK or India) and a holding company (which may be a joint stock company or an LLC) (Oman, 1974).

The investment law of 1993 and its subsequent amendments regulate the activities of non-Omani nationals wishing to engage in trade or business in the Sultanate or to acquire an interest in the capital of an Omani company (Oman, 1995c:Decree no. 57/93). According to this law, foreigners are allowed to own up to 49 per cent of any commercial company in Oman. Approval of the Minister of Commerce and Industry has to be obtained for foreign shareholdings exceeding 49 per cent and not exceeding 65 per cent, beyond that, approval of the Cabinet is required. Under the law, foreign investors are protected against nationalisation and ex-propriation.

The laws relating to property rights and collateral such as the 1980 Land Registry Law regulate ownership of land and property, their sale and purchase, while providing the mechanism for creating mortgages on them (Oman, 1995c:Decree no. 5/80). While, the Muscat Securities Market Law of 1988 and its subsequent amendments provides the regulatory framework for floatation and listing of joint stock companies on the securities market. It also provides the mechanism for private sector companies to raise capital by way of share or bond issue (Oman, 1995c:Decree no. 53/88). The 1981 law for establishing the Authority for Settlement of Commercial Disputes[1] provides the mechanism for rapid settlement of commercial disputes (Oman, 1995c:Decree no. 79/81).

In addition to these, there are a number of other laws like the Commercial Agency Law, Patents and Copyright Law which regulate commercial activity. Moreover, Oman's membership of the two affiliates of the World Bank, viz., Multilateral Investment Guarantee Agency and the Centre for Settlement of Commercial and Investment Disputes (Oman, 1995c:Decree no. 35/87) provides additional mechanism for resolution of commercial disputes, arbitration and protection of foreign investment. Similarly a large number of bilateral agreements have been signed with different countries for promotion of trade and investment, investment protection, and avoidance of double taxation.

For Omani companies (with or without foreign shareholding) which intend to undertake any industrial activity in Oman securing an industrial licence is obligatory. This is issued by the office of Industrial Registration at the Ministry of Commerce & Industry. In terms of industrial licensing, while before the 1980s, no more than one license would be issued for an industrial project, thus creating artificial rents for the holder of such a license, the system since the 1980s has been modified. Under the 1989 decree amending the Industrial Registration and Promotion Law, the applicant for a new licence in a particular industry is only made aware about the projects which have already been licensed (with information about its/their production capacity, etc.) and then it is left to his/her entrepreneurial judgement to take the risk of entering or not entering the concerned

[1] The Authority has in 1997 been converted to a full fledged Commercial Disputes court. This will provide it with more effective means to deliver and enforce its judgements.

industry. Therefore, the legal requirement of obtaining an industrial licence does not act as a barrier to new entry but enables the industrialists to arrive at a more informed judgement about the potential risk and opportunities in the new line of business which he/she may intend to enter (Oman, 1995c:Decree no. 80/89).

A major criticism levelled at developing countries relates, for example, to the complex and highly discretionary regulation for customs and taxes, which thwart competition and increase the cost of doing business (World Bank, 1995d). However, in Oman the low tariff structure ensures that the customs clearing procedures are fairly simple and straightforward. Moreover, the Tax Law of 1989[1], although discriminatory in nature, is applied with great efficiency (Oman, 1995c:Decree no. 77/89).

6.6 Public - Private Interaction in the Financial Sector

An efficient and vibrant financial system contributes much to economic development. It mobilises savings and allocates them to investments by private entrepreneurs. Therefore, fostering a robust financial system has been a part of the government's drive to promote an efficient market.

In Oman the government has used a variety of policies, mechanisms and instruments to achieve the objective. Unlike many developing countries, where most of the commercial banks are publicly owned, (World Bank, 1995d) in Oman — excepting the specialised banks — all banks are privately owned. This has enabled the Central Bank of Oman to enforce prudent lending and capital adequacy guidelines and strict supervision for avoiding bank failures[2].

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[1] In Oman, the main tax levied on commercial companies is the profits tax. The rate of this tax ranges between 5 to 7.5 per cent on wholly owned companies, 15 to 25 per cent on Omani and non-Omani joint ventures and between 25 to 50 per cent on wholly foreign-owned companies. Public Joint Stock Companies, even with foreign ownership, are treated as wholly owned companies, provided the foreign shareholding does not exceed 49 per cent (Oman, 1995c:Decree no. 77/89 and its subsequent amendments).

[2] In Mauritania and Tanzania, for example, public sector bank recapitalisation is estimated to have cost about 20 per cent of GDP in 1991 (World Bank, 1995d:p.131).

Moreover, as noted earlier in section 6.3.1, the government has adopted a prudent macroeconomic policy and thus has not resorted to the banking system to cover fiscal deficits. Neither have the SOEs in Oman resorted to commercial banks to cover their deficits or their financial requirements[1]. Moreover, most of the SOEs in Oman are profitable and are run on a commercial basis and, therefore, do not have to resort to the banking system to cover their losses. Thus, in Oman the situation is unlike many developing countries where, "Inefficient public enterprises grew at the expense of the more efficient private sector" (*ibid.*:p.124).

In order to provide trained manpower for the efficient working of the banking system, the Central Bank in partnership with the banks operating in Oman has established the Oman Institute of Bankers. As a result, the banks have been able to get up to 87 per cent of their manpower requirement from the domestic market (CBO, 1997:p.29).

While setting-up of new banks is restricted, the present number of 18 commercial banks with 276 branches (Oman, 1996b) operating throughout the country is considered more than adequate by international standards to introduce and foster competition in the banking system.

During the two decades of planned economic development, there has been a large expansion in the volume of short and medium-term credit supplied by commercial banks to the private sector. While the nominal GDP increased by about 6 times between 1976 and 1995, total commercial bank credit, as shown in table 6.4, grew during this period by about 9.6 times, from RO 147 million to RO 1,407 million. At the same time, credit to the government declined from RO 63 million to RO 26 million.

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[1] According to the Law of Signing Contracts or commitments in the name of governments, no ministry, department, or public enterprise is allowed to sign any such contracts or commitments unless these are countersigned by the Deputy Chairman of the Financial Affairs Council and the Undersecretary for Finance (Oman, 1995c:Decree no. 47/75). This prevents any government department or SOE from borrowing any funds without the explicit approval of the Ministry of Finance.

Table 6.4 also shows the sector-wise distribution of the commercial bank credit between 1975 and 1995. This reflects the changing structure of the economy. With the growth of manufacturing sector's share in GDP, its share in bank credit has increased from 0.7 per cent in 1975 to almost 4.6 per cent in 1995. The growth in bank lending to agriculture and fisheries is much more impressive as credit given to this sector increased from almost zero in 1975 to RO 10 million in 1995. On the other hand, the share of construction in bank credit declined from 11.6 per cent in 1975 to 9 per cent in 1995. All these changes in the sectoral distribution and the growth of total bank credit to private sector clearly indicate the rapid development of private businesses and the growing importance of the private sector in the economy.

We thus find that the government's policies have laid the foundation of a competitive banking system which in turn helps the development of a competitive private sector, since borrowers are not dependent upon a few banks. Moreover, the presence of foreign banks in Oman has further strengthened competition in the banking sector. In addition, the development of the MSM has provided alternative channels for raising long-term capital and thus contributed to deepening of the financial markets. And since all commercial banks are privately owned in Oman, they do not have to be privatised, with the risks and uncertainties that privatisation entails. This is clearly different from many developing countries where privatisation of non-private banks has become an important and complex issue.

Despite the growth in the banking sector, the level of financial depth of the system is still rather narrow. For example, the ratio of domestic credit provided by the banking sector in Oman, which is used as a measure of the growth of the banking system, was only 29.2 per cent of GDP in 1995, compared to 131.9 per cent for Malaysia, 54.1 per cent for Trinidad and Tobago and 53.1 per cent for Mexico (World Bank, 1997b:pp.268-270).

Another indicator of the efficiency of the financial sector is the margin between the cost of deposits (mobilising liabilities) and the interest charged on loans. As the *World*

Development Indicators state, "small margins are crucial for economic growth, since they reduce interest rates and thus the overall cost investment" (World Bank, 1997b:p.271). Moreover, interest rates reflect the responsiveness of financial institutions to competition. Although in 1995 the spread of 2.9 points between lending and deposit rates[1] in Oman was low compared to, for example, India where the spread was 6.5 points, Ireland 6.2 points, Trinidad and Tobago 9.1 points and Chile 4.5 points, it was nevertheless high compared to Malaysia, where the spread was 1.7 points and South Korea where it was 0.2 points (*ibid.*:pp.268-270).

Table 6.4

Sectorwise distribution of commercial bank credit, 1975 and 1995

(RO Million)

Sector	1975		1995	
	Amount (RO Mn.)	Relative share %	Amount (RO Mn.)	Relative share %
Trade	49	33.3	375	26.7
Mining	1	0.7	21	1.5
Construction	17	11.6	126	9.0
Manufacturing	1	0.7	65	4.6
Electricity, gas, water	1	0.7	9	0.6
Transport and communication	1	0.7	19	1.4
Financial institutions	-[a]	-[a]	54	3.8
Services	2	1.4	68	4.8
Government	63	42.9	26	1.8
Personal	10	6.8	442	31.4
Agriculture and fisheries	-[a]	-[a]	10	0.7
Others	2	1.2	191	13.7
Total	**147**	**100.0**	**1,407**	**100.0**

Note:
a) In 1975 credit to financial institutions amounted to RO 19,000 only, while to agriculture and fisheries it amounted to RO 10,000 (Oman, 1976a:p.330).

Source: Compiled from *Statistical Year Book 1985; and 1995* (Oman, 1986b:p.330 and 1996b:p.477).

[1] The irony is that this spread was as low as 1.4 points in 1990 (*ibid.*), when the Central Bank of Oman was imposing a ceiling on the maximum rate of interest that could be charged by commercial banks to their customers. However, based on the urging of the IMF to liberalise interest rates, the spread has more than doubled since interest rates have been liberalised.

6.7 Increase in the Volume of Private Sector Economic Activity

The measures taken by the state to foster private sector activities in Oman have produced considerable results at least in the first and easier phase of the country's development. It remains to be seen how the private sector will measure up in the next, rather more difficult, phase of developing manufacturing and other types of economic activities. We shall discuss this issue in Chapter VII.

As a result of state encouragement, the volume of economic activity involving the private sector has increased significantly. This increase is reflected in (i) the number of companies and establishments registered by type of legal entity; (ii) the number of companies classified by region and size of capital; and (iii) the growth of the MSM.

Table 6.5

Number of companies and establishments registered as legal entity[a] and relative distribution of registered companies and establishments by legal entity

Legal entity	1976		1985		1992	
	No.	%	No.	%	No.	%
Sole ownership	3,804	79.9	22,417	86.9	52,158	88.5
Limited partnership	254	5.3	519	2.0	1,277	2.2
General partnership	544	11.4	2,054	8.0	3,458	5.9
Limited liability	134	2.8	701	2.7	1,818	3.1
Joint stock	22	0.5	98	0.4	204	0.3
Total	**4,758**	**100**	**25,789**	**100**	**58,915**	**100**

Note:

a) Available data on distribution of registered companies and establishments by type of legal entity are for the period 1974-1992; since 1993 the Ministry of Commerce & Industry has been engaged in updating the data of the Commercial Registry.

Source: *Statistical Year Book 1985; 1993* (Oman, 1986b:pp.221-254; 1994c:pp.241-243).

Table 6.5 shows the growth of companies and enterprises from 1976 to 1992. The total number of companies of all categories increased from 4,758 in 1976 to 58,915 in

1992. The majority of companies in 1976 and in 1992 were in the category of sole ownership, that is, wholly owned by the private sector. In 1976 this category of companies formed almost 80 per cent of the total number of companies; by 1992 this figure has increased to 88.5 per cent of the total. For this category of companies, although the change in their proportionate share between 1976 to 1992 has not been very large, the number of companies in this category has increased vastly from 3,804 to 52,158 between these two years. This indicates the extent of expansion in the small business segment of private sector.

Table 6.6

Registered companies and establishments classified by region and size of capital

(000' Rials Omani)

Size of capital in 000' RO	0-10	10-50	50-100	100-250	250-500	500 and more	Total	Relative Share
Region	Nos.	Nos.	Nos.	Nos.	Nos.	Nos.	Nos.	%
Muscat								
1976	1,307	1,290	210	186	41	31	3,065	64.4
1995	9,797	8,400	2,399	1,561	436	359	22,952	30.4
Al Batinah								
1976	267	251	14	8	3	1	544	11.4
1995	13,255	4,611	637	157	17	7	18,684	24.8
Ad Dakhliyah								
1976	48	76	3	1	1	-	129	2.7
1995	4,006	2,360	194	94	9	2	6,665	8.8
Adh Dhahirah								
1976	30	41	3	1	-	-	75	1.6
1995	4,820	2,101	326	119	12	2	7,380	9.8
Musandam								
1976	-	1	-	2	-	-	3	0.1
1995	239	203	21	12	2	3	480	0.6
Dhofar								
1976	219	339	55	27	11	5	656	13.8
1995	5,397	3,361	355	124	31	25	9,293	12.3
Ash Sharqiyah								
1976	118	156	8	4	-	-	286	6.0
1995	4.914	4.057	395	66	2	-	9,434	12.5
Al Wusta								
1976	-	-	-	-	-	-	0	0.0
1975	396	187	12	3	-	-	598	0.8
Total for the Sultanate								
1976	1,989	2,154	293	229	56	37	4,758	100.0
1995	42,824	25,280	4,339	2,136	509	398	75,486	100.0

Source: *Statistical Year Book 1985; 1995* (Oman, 1986b:pp.221-254 and 1996b:pp.228-232).

A noteworthy characteristic of the data in table 6.6 is the change in the regional distribution of companies according to the size of their capital. This is commensurate with the government's policy of pursuing development which emphasises equity between regions. Thus in 1976, 64.4 per cent of registered companies in Oman were located in the capital Muscat. In contrast the number of registered companies increased in almost all other regions during the period, 1976 to 1995, while the percentage of companies registered in Muscat declined to 30.4 per cent in 1995. In Al Batinah the increase was from 11.4 to 24.8 per cent; in Ad Dakhliyah from 2.7 to 8.8 per cent; in Adh Dhahirah from 1.6 to 9.8 per cent; in Musandam from 0.1 per cent to 0.6 per cent. Only Dhofar experienced a decline from 13.8 in 1976 to 12.3 per cent in 1995.

Of course as table 6.6 shows, the regional distribution of companies by size of capital is still relatively unequal. The capital Muscat has a larger share of companies of all sizes in terms of capital, as compared with the other regions. So regional inequalities exist and are likely to persist[1] in so far as the distribution of private sector entrepreneurial activities are concerned; this is in spite of policies that seek to distribute these rather more equitably.

Another indicator of private sector development that we have chosen is the changes in the volume of different types of transactions on the MSM. Table 6.7 shows these trends during 1990-96.

[1] For instance, as can be seen from table 6.6, the share of companies in Muscat with capital of more than RO 250 thousand increased from 77 per cent in 1976 to 87 per cent in 1995.

Table 6.7
Growth of the Muscat Securities Market (MSM)[a] 1990-1996

Items	1990	1991	1992	1993	1994	1995	1996
1. Number of companies listed on MSM	56	58	60	66	71	83	98
1.1 Regular market	50	41	39	39	34	38	39
1.2 Parallel market	6	17	21	27	37	45	59
2. Market capitalisation (RO Mn.)	363.3	426.5	408.5	420.0	655.7	761.5	1,059.8
2.1 Regular market	333.8	398.3	374.6	354.1	455.1	474.3	708.8
2.2 Parallel market	29.5	28.2	33.9	65.9	200.6	287.2	351.0
3. Market capitalisation as (%) of GDP[b]	8.1	9.8	8.5	8.7	13.2	14.4	18.1
4. Turnover or trading volume (RO Mn.)	45.7	56.6	39.4	41.7	93.1	81.4	210.1
4.1 Regular market	41.6	53.6	36.8	30.5	63.1	45.8	135.2
4.2 Parallel market	4.1	3.0	2.6	11.2	30.0	35.6	74.9
5. Turnover as a (%) of GDP	1.0	1.3	0.8	0.9	1.9	1.5	3.6
6. Turnover as (%) of market capitalisation	12.6	13.3	9.6	9.9	14.2	10.7	19.8

Notes:

a) MSM started its operations in 1990

b) For 1990-1996, the GDP figures are (RO Million): 4,493; 4,360; 4,787; 4,803; 4,967; 5,288; and 5,854 respectively (Oman, 1996b).

Source: Oman, MSM, *Annual Reports 1991; 1992; 1993; 1994; 1995; 1996.*

Between 1990 and 1996, the number of companies listed on the MSM nearly doubled from 56 to 98. During this period market capitalisation increased by about three times, from RO 363.3 million to RO 1,059.8 million and as a percentage of GDP market capitalisation increased from 8.1 to 18.1 per cent. All the other indicators in table 6.7 show increased activity on the MSM, which reflects both directly and indirectly increased private sector activity in Oman's economy.

6.8 Expansion of Information Base

Inadequate access to commercially useful information and non-availability of economic data are serious obstacles to development of markets and private enterprise in many underdeveloped countries. An important element of public-private partnership is the dissemination of timely and reliable information on economic and business activity. As we saw in Chapter IV, up to 1970 even the basic information such as national income, population, etc. about Oman's economy were neither officially compiled nor published[1].

However, with the launching of a vigorous development policy in the early 1970s and commencement of development planning in 1976, a number of steps have been taken by the government to develop a modern network of statistical data and information. These have included, for example, the enactment in 1988 of a law regarding collection, analysis and dissemination of statistical information (Oman, 1995c:Decree no. 87/88). This law vests the authority for national statistics in the Ministry of Development (MOD)[2]. To enable it to monitor and evaluate socio-economic progress, the Ministry conducts monthly surveys of consumer prices, quarterly and annual surveys of production and periodical social surveys. In addition, other government ministries also conduct regular surveys, relating to their activities in co-ordination with the Ministry of Development.

Another important development has been the conducting of the first ever census of population, housing and establishments in 1993. Similarly, an Agricultural Census was carried out in 1993 and an Industrial Census was carried out in 1994 (Oman, 1996a:p.137).

As a result of these efforts, a number of monthly, quarterly and periodical bulletins are published. The annual *Statistical Year Book* issued by the Ministry of Development, for example, provides comprehensive and up-to-date time-series data on Oman's economic and social development. The monthly bulletin issued by the Ministry provides monthly and quarterly socio-economic indicators which cover, *inter alia*, consumer prices, public finance, national income accounts, imports and exports, construction activity and so on. Moreover, for the benefit of the general public the Ministry of Development regularly

[1] Most of the data for pre-1970 are estimated by international organisations like the United Nations and the World Bank.
[2] This authority was originally vested in the Technical Secretariat of the Development Council before the formation of the Ministry of Development on 4.1.1994 (Oman, 1995c:Decree no. 2/94).

publishes special reports giving full details of the FYPs including their objectives, policies, programmes and projects.

In addition, a number of ministries, including the Ministries of Health, Education, Agriculture and Fisheries issue annual reports relating to their activities. The Central Bank of Oman also provides detailed information regarding the banking sector in its annual reports and quarterly bulletins. PDO in its annual report and periodical newsletter gives up-to-date information on developments in the petroleum and gas sectors.

The MSM publishes a monthly bulletin and an annual report which provide full details of movements in prices of shares of all listed companies together with other useful information on these companies, such as their turnover, profits, dividends, market capitalisation and so on. In addition, the data on traded shares are published daily in Oman's English and Arabic newspapers.

Government agencies, therefore, regularly collect and disseminate a wide range of economic and social information in order to assist private individuals and enterprises in making decisions on business opportunities and viability of projects.

6.9 Role of Market Mechanism in Oman

We have seen that development planning and the crucial role of government in promoting economic and social development in Oman have not resulted in any wasteful or stifling relationship between public and private sectors, and that the interests of the two sectors have evolved in such a way that they are complementary rather than conflicting. These two features of Oman's development during the period 1976 to 1995 explain how the planners in Oman have been able to implement the long-term objective of encouraging the existence of freely competitive market mechanisms and promoting private enterprise.

As mentioned already, there are two main areas where the operation of market forces has been left almost completely free. One is external trade. Oman's principal export is oil, which is subject to forces operating in the world oil market. Oman has no influence in determination of oil price because of its small share in the total world oil supply. Since the world oil price is expressed in US dollars, Oman's exchange rate policy cannot influence the export price of oil. The domestic cost of oil production also has no effect on the price that Oman receives. Other non-oil exports are also not subject to any form of export taxes or charges and are almost entirely undertaken by the private sector.

Secondly, in relation to imports, quota restrictions are almost non-existent[1] and only a nominal tariff of 5 per cent is levied on non-food items. Even the exchange rate which is pegged to the US dollar is held constant. Thus imports of goods, services, capital and technology are not subject to any policy restrictions. The result is that in the sphere of foreign trade, Oman has diligently followed the free trade policy based on the neo-classical theory of comparative cost advantage. The policy of unrestricted imports has helped Oman in controlling inflation despite increasing deficits in government finances. The decision to adopt a liberal trade policy has been influenced on the one hand, by the high share of oil exports in foreign trade and on the other, by the small size of import-competing industries and agriculture.

The other area of the economy where the Omani government has consciously refrained from interfering with the operation of market mechanism is that of allocation of the available supply of goods and services among their buyers. This primary function of market system is thus not interfered with through any measure of rationing or price control. Thus internal trade in foreign or domestically produced goods is governed entirely by free market forces. Moreover, since nominal customs duty on non-food

[1] Only in a few cases licenses are required to import certain agriculture products when they are in competition with local produce. However, these licences are easily awarded.

imports is the only form of indirect tax, market functioning in Oman is not distorted through the existence of indirect taxes[1].

There are, of course, industrial subsidies; but their relative importance in industrial value-added is not significant enough to cause any distortions in the price mechanism. According to the World Bank's estimate (World Bank, 1994a:p.82), the share of various input-related subsidies in Oman accounted for only 11 per cent of total industrial value-added in 1991. This magnitude of the ratio of subsidy to value-added is low enough so as not to cause any significant allocative distortion. Moreover, total budgetary support to the private sector accounted on average for less than 2 per cent of annual total public expenditure during 1991-95 (Oman, 1996b:p.436). In other words, the state intervention in promoting the market has not caused serious distortions in resource allocation.

Thus in Oman although planning and direct involvement of government play a dominant role in the development process, the policy framework is broadly speaking "market conforming" in that it facilitates the functioning and expansion of the market system. In this Oman stands out as an example where the roles of the state and market have been synergetic and not adversarial. The two institutional instruments of development are not conflicting; in fact they are acting in co-operation with each other.

6.10 Conclusion

We have seen in this chapter that with the commencement of the era of development planning in 1976, the government of Oman had in its 1975 long-term development policy statement declared its commitment to promote and sustain freely competitive markets and free trade. The basic approach in Oman's development policy is to ensure that planning does not substitute markets and that the roles of the state and the private sector are complementary and not conflicting. Unlike China and India, for

[1] This is with the exception of petroleum products where a 50 per cent tax on domestic consumption is imposed (Al Yousef, 1995:p.39); and prices of products and services that are provided by natural monopolies such as electricity, water, gas and telephones, which are set by the government.

example, Oman has refrained from demarcating the boundaries between the activities of the state and private sector. In respect of the roles of planning and market, Oman's approach has some common features with the approaches of Japan and South Korea, as we discussed in Chapter III.

Through the resources generated from the primary produce, oil, the state has played the leading role in initiating and sustaining the development process during 1970-95. It has invested large sums of money in economic and social infrastructure to facilitate private sector development. It has also taken up the role of the entrepreneur by putting in motion the process of diversification. At the same time, it has provided a number of financial incentives to induce private sector investment.

The state has developed a comprehensive framework of regulations and laws to facilitate private sector activities, in addition to providing a wide range of statistical information to assist it in making decisions regarding business opportunities. Equally important has been the role of the state in promoting a robust financial sector, which, as we noted, has been instrumental in promoting the growth of the private sector.

This chapter has shown that the role of the private sector is very important in most of the non-oil economic activities and even in the oil sector, where foreign private sector has played a very important role. In terms of GFCF we have seen that although the share of the private sector is relatively small, it has been growing since the Second FYP. An important aspect of capital formation is the complementary role played by the public and private sectors in the sectoral distribution of investment. What is of great significance is that while the role of the state in the initial stages of development was stronger in certain activities, such as tourism and housing, the government has itself initiated appropriate policies to gradually reduce its role, because the private sector is now in a better position to conduct those activities.

As a result of a conscious government policy, most of the activities in Oman's economy are operating wholly through the market. These include non-oil foreign trade, internal trade and exchange of most goods, services and finance between suppliers and buyers. Public utilities and basic inputs provided by the state enterprises are also supplied on market principles with the result that the SOEs providing these services are generally run on a commercial basis. Thus the state through development planning has facilitated the expansion of market mechanism and has attempted to ensure that these two institutions reinforce each other.

CHAPTER VII

THE NEW DEVELOPMENT STRATEGY AND POLICY IN OMAN OF THE 1990s

7.1 Introduction

In spite of the impressive development[1] achieved by Oman since the late 1970s some serious problems still need to be overcome. These problems which are embedded in Oman's economy are an obstacle to further structural transformation[2], and their solution constitute the major objectives of the New Development Strategy and Policy[3] which is articulated within the 'Vision 2020' framework. Specifically, this chapter examines the main elements (diversification, private sector and HRD) of the New Development Strategy which is formulated in the context of, and whose focal point is, the depletion of Oman's oil reserves by the year 2020. This chapter will also examine the future role of the State in Oman's development because although the strategy underlying the 'Vision 2020' does not envisage "rolling back" of the state, it does envisage a reconstitution of the state's role in the development process.

This chapter thus has two main objectives. Firstly to describe the main problems that constrain Oman's further development and secondly to analyse the strategies and policies formulated, within the planning framework to overcome these constraints in which

[1] As we noted in Chapter IV, Oman has made rapid socio-economic progress over the last quarter century. Oman's nominal GDP has increased from RO 104 million in 1970 to RO 5,288 million in 1995, while per capita income has increased from RO 158 to RO 2,477 between these two years. Life expectancy has increased to 67.4 years and infant mortality has declined to 20 per 1,000 live births, while primary education has become universally accessible (Oman, 1996c:pp.5-6).

[2] The interrelated processes of structural change that accompany economic development are jointly referred to as the *structural transformation.* The accumulation of physical and human capital and shifts in the composition of demand, trade, production and employment are described as the economic core of the transformation, while the related socio-economic processes are identified as peripheral (Syrquin, 1988:p.206).

[3] Referred to also as the New Development Strategy.

both the state and market play a role. The main problems which will be dealt with consecutively are diversification of the economy, privatisation and private sector development and human resource development.

Since macroeconomic management is identified as an essential factor in achieving the objectives of the New Development Strategy, we shall also examine in this chapter the main policies proposed to achieve macroeconomic stability.

7.2 Oman's Vision for the Year 2020[1]

The possibility of depletion of oil reserves within the next two decades combined with a predominantly young and rapidly growing population[2] puts the Omani government under great pressure to pursue a policy of diversification with great urgency with a view to minimise dependence on the oil industry and at the same time maximise employment opportunities for the Omani population (Oman, 1996a: Chapter IV). The 'Vision 2020' and the New Development Strategy and Policy therefore represent a new era of state-led development which places great emphasis on development of human resources, economic diversification and private sector development.

The prime objective of the vision for Oman's economy over the next quarter of a century is to maintain the current level of per capita income in real terms as a minimum, and to strive to double it in real terms by the year 2020. The Vision also aims to provide appropriate conditions for economic take-off. In this regard, the government plans to use the resources generated from the petrochemical sector, oil and gas, in promoting sustainable economic diversification, while accepting full responsibility for the provision of basic health and education facilities, in addition to training Omanis and upgrading their skills (Oman, 1996a:p.168).

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[1] This is because the 'Vision 2020' provides a twenty-five years perspective for the Omani economy and society, from 1996 till 2020 (Oman, 1996a).

[2] More than half of the Omani population is under 15 years of age, (Oman, 1993a:p.37) and its average growth rate is 3.7 per cent per annum (Oman, 1996c:p.6).

Since Oman implements its strategies through five-year plans, the specific policies and programmes included in the Fifth FYP have been formulated in conformity with the realisation of the main goals of the 'Vision 2020'.

In support of the new strategy a large number of policies and projects have been approved. These include, for example, setting up of the Omani Centre for Investment Promotion and Export Development (OCIPED), joining the World Trade Organisation (WTO), setting up a venture capital fund to promote growth of small and medium size enterprises, optimising the advantages of Oman's strategic location, upgrading general education standards and introducing modern vocational training programmes.

7.3 The New Development Strategy and Diversification

To achieve change in the structure of composition of the GDP by the year 2020, the New Development Strategy places added emphasis on high value-added strategy, export diversification, integration with the global economy, encouraging technology transfer, research and development, and promotion of newer sub-sectors such as electronics and software.

Table 7.1 indicates the policies of the new long-term strategy which aim to achieve a major shift in the sectoral composition of production in the economy. It is expected that the value-added by the non-petroleum activities would reach 81 per cent of real GDP by 2020 compared to 65 per cent in 1995. By the year 2020, it is estimated that the contribution of the petroleum sector[1] to real GDP will decline to 19 per cent. This significant transformation in the structural mix of the production base of the Omani economy constitutes the core of Oman's attempt at economic diversification.

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[1] As table 7.1 shows, because of the depleting oil reserves, contribution of crude oil to the GDP will decline from 33.5 per cent in 1995 to 9.0 per cent in 2020, while the contribution of the gas sector is expected to increase from 1.5 per cent in 1995 to 10.0 per cent in 2020.

Table 7.1

Structure of the economy : production (at 1993 constant prices)
Distribution of gross domestic product :1995[a], 2000 and 2020

(per cent)

Sector	1995[a]	2000	2020
Petroleum sector value-added:	**35.0**	**30.9**	**19.0**
Oil	33.5	25.9	9.0
Gas	1.5	5.0	10.0
Non-petroleum activities value-added:	**65.0**	**69.1**	**81.0**
Agriculture	3.0	3.5	3.1
Fisheries	1.1	1.0	2.0
Mining and quarrying	0.6	0.6	2.0
Manufacturing	5.4	6.8	15.0
Electricity and water	1.7	4.3	2.0
Building, construction and real estate services	3.2	6.9	10.0
Trade and tourism	14.1	17.8	18.0
Transport and communications	7.0	8.6	8.0
Banks, insurance and financial services	7.9	4.3	8.0
Other services[b]	8.3	3.2	5.0
Public administration	13.9	12.6	10.0
Imputed banking services, net of custom duties	-1.2	-0.5	-2.1
Gross domestic product at market prices	**100.0**	**100.0**	**100.0**

Notes:

a) The structure of the GDP for the year 1995 as shown in table 7.1 is different from that shown elsewhere in this and other chapters. This is because it is based on 1993 constant prices, the year when the estimates for the Oman's 'Vision 2020' were being formulated.

b) Educational and medical services, film distribution and exhibition, car repairs, laundry and sanitation services, domestic services and cosmetic services.

Source: Oman, *Fifth FYP* (1996a:p.240).

As table 7.1 shows, some profound changes are anticipated in the production structure of the Omani economy during the period 1996-2020. Thus in the petroleum sector, although the relative significance of oil in the economy is projected to decline to 9 per cent by the year 2020 from 33.5 per cent in 1995, part of this decline is planned to be compensated by the gas sector. As we shall see later, the Fifth FYP comprises an ambitious programme to develop the gas sector over the next 25 years, and this is to be done through a public-private partnership.

Since the significance of diversification for Oman lies in the need to expand the value-added in the commodity producing sectors of agriculture, fisheries, non-oil mining and manufacturing, it is forecast that the total value-added by these sectors will increase from 10.1 per cent of GDP in 1995 to 22.1 per cent in 2020. And to realise these structural changes the structure of the demand will undergo similar changes. Thus the ratio of GFCF to GDP is projected to increase from 14.5 per cent in 1995 to 34 per cent in the year 2020. This is planned to be achieved partly by reducing gradually the ratio of final consumption to GDP, from 79 per cent in 1995 to 68 per cent by the year 2020 (Oman, 1996a:p.186).

7.3.1 Diversification : definition and issues

As we discussed in Chapters I and II, development is a process of transition from a socio-economic structure with a lower to a higher productive capacity. Thus development policy deals with ways in which different sectors[1] of the economy adapt over time to changes in demand, factor supplies, and technology. Economic diversification, therefore, refers to significant transformation in the structural mix of the production base of the economy, with a view to avoiding excessive dependence on a single resource or a depletable resource, and to the promotion of diverse activities to change the composition of national output and income. Practically, this implies adding new economic sectors to the domestic economy; for example, agriculture develops newer and additional sub-sectors: arable farming, milk and dairy products, meat and meat products, fruit, vegetables and so on. In industry, this would mean development of consumer goods, electronics, software, labour-intensive products, capital goods, machine tools and various other items. Similar additions and multiplication are also possible in the services sector. Even though the structure of production may change over time from one sector to another, the existence and multiplication of these sectors are the defining characteristics of a diversified

[1] However, it is notable that neo-classical economics makes little use of conceptual distinction among sectors of production, such as agriculture and industry. "In an open economy with competitive markets, all tradable goods are highly substitutable and the main sectoral distinction that needs to be made is between tradables and non-tradables" (Chenery, 1988:p.198).

economy. Another characteristic of this process is the linkages connecting sectors together, i.e. backward and forward linkages (Hirschman, 1958). Diversification, therefore, implies, *inter alia*, deepening of the national economy.

In a classic statement on the relationship between diversification and development in developing countries, Streeten and Elson (1971:p.13) assert that:

> ... [W]hile it is broadly true, both that countries are poor because they are not diversified (and therefore particularly vulnerable to changes in technology and demand), and that they are not diversified because they are poor, the more fundamental of the two relations is the second. Diversification is not so much the condition of successful development, as it is its result.

Streeten and Elson's statement underpins Oman's strategy of diversification. For it anticipates the depletion of a valuable resource, oil, which, if depleted, may reduce Oman's wealth which has depended on good management of this commodity. In some ways of course, Oman's strategy inverts Streeten and Elson's conception of diversification: Oman is diversifying both to increase and sustain its wealth and to prevent it from becoming poor once the oil runs out.

Major arguments for diversification for a single resource or a depletable resource economy have centred around: (i) avoiding shocks of adverse terms of trade between primary commodities and manufactured products (the Prebisch-Singer thesis, referred to in Chapter II); (ii) encouraging domestic resource-based industrialisation (Auty, 1990), and creating new sources of income; (iii) developing new economic sectors and promoting employment; and (iv) strengthening inter-linkages in the different sectors of the economy (Hirschman, 1958 and 1977).

7.3.2 Constraints to diversification

In order to formulate a revised and more dynamic policy for diversification, the government carried out an extensive review of the Omani economy in 1994 and 1995[1]. The purpose of this review was to identify the major constraints and challenges that needed to be overcome if diversification was to be achieved. The findings of these studies are summarised below.

First, unlike in the past 25 years (1970-95), Oman is faced with the prospect of declining oil reserves during 1996-2020. In the earlier phase, oil-induced growth was able to sustain the momentum of development in the economy which seems unlikely in the next phase.

Second, there have been weak linkages between oil and the rest of the economy. Oil has hardly succeeded in promoting sustained and autonomous growth in the non-oil sectors, which remain heavily dependent on the oil sector. According to Gelb, the weak structure of the non-oil sectors is a consequence of a number of complex factors; among these, the Dutch disease effects of the oil boom are not the least important (Gelb, 1988:pp.134-43).

Third, the Omani economy suffers from a low level of productive efficiency mainly because of inadequacy of trained local manpower for the middle and higher management levels. Moreover, most of the expatriate labour force has been engaged in low value-added activities.

Fourth, private sector participation in the economy has been limited despite a range of incentives, public support programmes and a flexible and supportive regulatory

[1] Oman's Fifth FYP contains a detailed note about this review,, and the policies suggested to achieve the goals of Oman's 'Vision : 2020' (Oman, 1996a:Chapter 3).

framework. Rather, the economy has witnessed the emergence of monopolies and a rentier mentality, foregoing competitiveness and efficiency in the process.

Fifth, the growing savings-investment gap is likely to be a major structural constraint on the Omani economy in the future. High consumption induced growth (both private and public) is sustainable only if the marginal rate of savings is high.

Sixth, the quality of general education and of vocational training has been below the standard required to enable the Omanis to manage and adapt to changing technology.

Seventh, the small size of the Omani population and hence the limitation of the domestic market also pose a major constraint on investment in the capital-intensive goods sector. Though the Gulf Co-operation Council (GCC) does provide a larger market, more efforts are needed to expand the market for supporting a wider range of activities.

In order to overcome these constraints and accelerate the pace of structural transformation, the government has produced a comprehensive package of policies and measures, the main elements of which are examined below.

7.3.3 Fifth FYP (1996-2000) and diversification

To achieve the multiple objectives of diversification, an expanded role for the private sector and further integration with the global economy, it is expected that major economic sectors will witness dramatic changes. For instance, while the average annual growth rate of the petroleum sector[1] is estimated to be 1.1 per cent in nominal terms during the Fifth FYP, the non-oil sector[2] is planned to grow at 6.3 per cent on average per

[1] This includes oil and gas industries. The estimated average annual growth rate for gas industry is 36.4 per cent, while the oil industry because of an expected downturn in prices, is estimated to *decline* by an average annual rate of 0.7 per cent, both in nominal terms (Oman, 1996a:p.315).
[2] The terms oil sector, petroleum sector and petroleum activities and non-oil sector, non-petroleum sector and non-petroleum activities are used interchangeably in this chapter.

annum. As a result, nominal GDP is planned to grow at an average annual growth rate of 4.6 per cent. Within the non-oil sectors, the commodity sector[1] is planned to grow at 13.7 per cent per annum on average during the period 1996-2000 (Oman, 1996a:p.315).

The Fifth FYP also aims to diversify the non-oil exports. While total merchandise exports are planned to grow at an average annual rate of 3.8 per cent, the exports of locally produced non-oil products are planned to grow at an average annual rate of 17.6 per cent, and re-exports are expected to rise annually by 14.3 per cent on average. Thus it is envisaged that the high growth rates to be achieved in the non-oil exports will more than compensate the expected decline at an average annual rate of 0.6 per cent in oil exports. Moreover, it is expected that the trade surplus will also grow at an average annual rate of 4.7 per cent because of the expansion in non-oil exports (*ibid.*:pp.314-18). In terms of export diversification, the example of Malaysia is instructive[2].

7.3.4 Diversification indicators : analysis of trends

Since the sectoral composition of the output of the economy in Oman is divided between two main activities, petroleum and non-petroleum[3], we shall use the activities falling under these headings as proxies for the main indicators of diversification.

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[1] The term commodity sector and goods producing sector are used interchangeably. This sector includes non-oil mining, agriculture and fisheries, manufacturing, electricity and water, and construction (*ibid.*).

[2] Malaysia's *Second Outline Perspective Plan* states: ... [W]ithin the primary commodities sector, palm oil, petroleum and LNG offer the best prospects for boosting export earnings. On the other hand, exports of manufactured goods will become increasingly important with its share expanding from about 60.4 per cent of the value of total exports in 1990 to 81.8 per cent in the year 2000. Within manufacturing the high growth sectors are anticipated to be food processing, industrial chemicals, textiles and clothing, rubber products and non-metallic mineral products. The growth of the electrical machinery and equipment sub-sector is anticipated to slow down relative to other sectors within manufacturing. Although exporting sizeable volume of primary goods, the rapid increase in manufacturing exports during 1971-90 and now planned for 1991-2000 has enabled Malaysia to achieve a diversified export basket over the past twenty-five years (Malaysia, 1991:p.79).

[3] The analytical division of the economy is based on composition of demand (consumption, capital formation and net savings) and composition of production (output of the various sectors of the economy). Although the most widely used categorisation is Kuznet's division of production into agriculture, industry and services (Chenery, 1988:p.199) because of the importance in Oman's economy of the petroleum sector on one hand, and the need, on the other hand, to reduce dependence on that sector through diversification, production is principally divided into two main sectors petroleum and non-petroleum. Each of these is then further sub-divided into a number of sectors and activities.

However, our assessment will be limited to the main activities, since the results of the successive five-year plans in promoting a diversified economy have been discussed in Chapters IV and V.

Table 7.2 shows the structure of production in the economy during the period under study. It reveals that the relative share of value-added by petroleum activities declined from 58.5 per cent in 1976 to 38.2 per cent in 1995, whilst the relative share of value-added by non-petroleum activities has increased from 41.5 per cent to 61.8 per cent between these two years.

In the petroleum activities, crude oil has maintained its dominant position because development of the gas sector has been limited up to now for domestic consumption. However, with the discovery of a large quantity of gas reserves, the government has launched within the framework of the Fifth FYP an ambitious programme for commercial exploitation of these reserves. Table 7.1 shows that it is the value-added by the sub-sector of gas that will gradually increase to 5 per cent of GDP by the year 2000, and further to 10 per cent by the year 2020, thus overtaking the share of value-added by crude oil sector in 2020.

Within non-petroleum activities, the value-added by the commodity sector has been rather stable throughout the period; but the relative contribution of the individual sub-sectors in this sector has undergone significant changes. For example, manufacturing sector's share has recorded an impressive growth from 0.5 per cent in 1976 to 4.6 per cent in 1995.

Table 7.2

Structure of the economy : production

Distribution of GDP (at current prices) : 1976, 1980, 1985, 1990 and 1995

(per cent)

	1976	1980	1985	1990	1995
Petroleum activities value-added:	**58.5**	**62.0**	**49.6**	**47.7**	**38.2**
Crude oil	58.5	61.4	48.6	46.6	37.3
Natural gas	-	0.6	1.0	1.1	0.9
Non-petroleum activities value-added:	**41.5**	**38.0**	**50.4**	**52.3**	**61.8**
Commodity producing sector	**13.3**	**9.9**	**11.7**	**9.0**	**11.3**
Mining and quarrying	-	-	0.3	0.3	0.3
Agriculture and fisheries	2.1	2.6	2.3	2.6	2.9
Manufacturing	0.5	0.8	2.2	2.9	4.6
Electricity and water	0.7	0.8	0.8	0.9	0.9
Building and construction	10.0	5.7	6.2	2.3	2.6
Services sector	**28.2**	**28.1**	**38.7**	**43.3**	**50.5**
Government services[a]	7.9	9.4	14.3	17.6	19.2
Other services[b]	20.3	18.7	24.4	25.7	31.3
Gross Domestic Product	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
GDP at market prices (RO Million)	**884**	**2,064**	**3,591**	**4,493**	**5,288**

Notes:

a) Government services include public administration and defence, education, and health.

b) Other services include trade, tourism, transport and financial, real estate and business services. These are net of imputed bank charges and custom duties.

Sources: Columns 1 and 2 from Oman (1986b:pp.396-402) and data for 1980 are based on old national accounts methodology. Column 3, 4 and 5 from Oman (1996b:pp.379-384) and data are based on SNA, 1993.

As indicated in table 7.3 the value-added in manufacturing has increased from RO 4.3 million in 1976 to RO 248.7 million in 1995, representing an increase of almost 60 times, while the GDP has increased by about 6 times from RO 884 million in 1976 to RO 5,288 between these two years.

The various sub-sectors of the manufacturing sector have also grown over the last two decades. The value-added by the refined petroleum products has increased from RO 14 million in 1985 to RO 55 million in 1995, whilst its relative share in the total value-added in the manufacturing sector has grown from 17.8 per cent to 22.0 per cent between these two years. The other sub-sectors — food processing, weaving, apparels etc. — have also increased their value-added by about 65 per cent between 1990 and 1995.

However, because the value-added by refined petroleum products grew by 270 per cent between 1990 and 1995, whereas the value-added by other non-petroleum manufacturing grew by 66 per cent only, the relative share of the latter in manufacturing went down from 89 per cent to 78 per cent between these two years. This of course is a cause concern and indicates the prevailing constraints and frailties in the Omani economy.

Table 7.3

Manufacturing sector in Oman : value-added by sub-sectors and their relative share

(a) Value-added[a]

(RO Million)

	1976	1980	1985	1990	1995
Manufacturing value-added (1+2)	**4.3**	**14.0**	**78.9**	**131.7**	**248.7**
1 Refined crude petroleum products	**0.0**	**0.0**	**14.1**	**14.8**	**54.8**
2 Other manufacturing	**4.3**	**14.0**	**64.8**	**116.9**	**193.9**
2.1 Food products and beverages.	NA	NA	NA	21.9	40.1
2.2 Wearing apparel	NA	NA	NA	12.2	31.3
2.3 Metallic mineral products	NA	NA	NA	33.5	40.6
2.4 Fabricated metal products	NA	NA	NA	10.6	15.5
2.5 Other manufacturing	NA	NA	NA	38.7	66.4

(b) Relative shares

(per cent)

	1976	1980	1985	1990	1995
Manufacturing value-added (1+2)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
1 Refined crude petroleum products	**0.0**	**0.0**	**17.8**	**11.2**	**22.0**
2 Other manufacturing	**100.0**	**100.0**	**82.2**	**88.8**	**78.0**
2.1 Food products and beverages.	NA	NA	NA	16.6	16.1
2.2 Wearing apparel	NA	NA	NA	9.3	12.6
2.3 Metallic mineral products	NA	NA	NA	25.4	16.3
2.4 Fabricated metal products	NA	NA	NA	8.0	6.2
2.5 Other manufacturing	NA	NA	NA	29.4	26.7

Note:

a) Value-added is the net output of a sector after adding up all outputs and subtracting intermediate inputs. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources. The Industrial origin of value-added is determined by the International Standard Industrial Classification (ISIC) (World Bank, 1997b:p.137).

Source: Compiled from internal data of the Ministry of Development.

The sectoral shift observed in Oman's (nominal) GDP components is in conformity with the empirical findings of Chenery and Syrquin (1986) that as per capita income rises, there is a shift from the production of primary goods to the industrial and services sector. In the case of Oman, this has taken place from oil to non-oil sectors, with oil serving as the engine of growth throughout the period.

If we look at charts 7.1 and 7.2 showing two different stages of Oman's development, it is clear that in 1970 (chart 7.1) the Omani economy was relatively undiversified, with the primary sector contributing 84.3 of the GDP, the secondary sector consisting mainly of construction, contributing 8.4 per cent and the tertiary sector 7.3 per cent. However by 1995, the relative shares of these sectors had changed significantly and about one dozen sub-sectors in the manufacturing sector alone had been added to the economy (chart 7.2).

Although this structural change is significant, it is by no means sufficient to ensure that Oman's present relatively high standard of living is maintained in future when oil gets depleted. The large increase in the non-oil sector is problematic because looked at closely, it is top-heavy compared to the relatively low depth of the non-oil productive structure of the economy. This, of course, poses a great cause for concern. The fast growth of non-oil sectors is not indicative of growth in the production of physical outputs or commodities, i.e. intermediate or consumption goods.

Another cause of concern, and one which provides a further justification for accelerating the diversification process is the continuous decline in Oman's export prices, especially oil. Table 7.4 below shows that whereas the value-added by crude oil sector, in 1988 constant prices, increased by 193 per cent between 1980 and 1995, in nominal terms the increase was only 51 per cent. This reflects the concern of the Centre-Periphery school, discussed in Chapter II, about the impact of the decline in terms of trade on development in the peripheral economies. The same is the case with agriculture and fisheries, where growth in value-added of 172 per cent in real terms was higher than the growth of 158 per cent recorded in nominal terms.

Table 7.4

Structure of economy : production

Growth of GDP at current and constant prices - 1980 and 1995

	Current			Constant (1988) prices)		
Sector type	**1980** **RO Mn.**	**1995** **RO Mn.**	**Rate of growth 1980-95 %**	**1980** **RO Mn.**	**1995** **RO Mn.**	**Rate of growth 1980-95 %**
Petroleum activities	**1,322**	**2,021**	**53**	**578**	**1,725**	**198**
1. Oil	1,311	1,974	51	567	1,659	193
2. Natural gas	12	47	292	11	66	500
Non petroleum activities	**862**	**3,267**	**256**	**1,041**	**3,048**	**193**
1.Non-oil industry[a] of which:	140	445	218	154	463	200
Manufacturing	14	241	1,621	18	236	1,211
2. Agriculture and fisheries	59	152	158	60	163	172
3. Services	660	2,670	304	827	2,422	193
Total GDP	**2,185**	**5,288**	**142**	**1,619**	**4,773**	**195**

Note:

a) Includes non-oil mining, manufacturing, electricity and water and construction.

Source: Oman (1986b:pp.379-388; 1996b) *Statistical Year Book 1985 and 1996*.

In contrast, as table 7.4 shows, between 1980 and 1995 the growth of 304 per cent in the nominal value-added by the services sector, was much higher than the growth of 193 per cent in real value-added by this sector. This reflects the non-tradable character of this sector and hence its ability to demand higher prices. Moreover, the high growth rates achieved by this sector both in real and nominal terms have, on the one hand, resulted in the premature expansion of the services sector, while, on the other hand, the liberal trade policy and fixed exchange rate of the Omani Rial *vis-à-vis* the US dollar have prematurely exposed domestic production to foreign competition. Therefore, and despite high growth rates in real terms, the growth in the relative share of manufacturing in the output of the economy has been much lower than that of the services sector.

Another important indicator of diversification relates to Oman's employment structure in relation to different activities. With the growth of the non-oil sectors during 1976-95 employment opportunities for Omani as well as expatriate labour have increased. However, we find from table 7.5 that most of the employment opportunities have been created in the services sector[1]. Whereas, the employment in this sector formed only 32.5 per cent of total employment in 1976, by 1995 the relative share of this sector in total employment had grown to 65.8 per cent.

The new development policy also aims to diversify government revenues gradually, so that by the year 2020, at least 60 per cent of total public revenues are to be derived from non-oil revenues (Oman, 1996a). At the same time, and as we shall see later, with the growth of private sector activity, it is expected that the ratio of public expenditure to GDP will gradually decline.

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[1] This comprises trade and restaurants, transport and communications; finance, real estate and business services; social and community services; and public administration and defence (cf. table 7.5).

Table 7.5

Total Omani and Non-Omani employment[a] in public and private sectors by economic activity in selected years

	1975				1993				1995			
	Omani	Expat-riate	Total	Relative share %	Omani	Expat-riate	Total	Relative share %	Omani	Expat-riate	Total	Relative share %
1. Private sector												
- Agriculture	10,951	2,282	13,233	9.5	19,993	40,789	60,782	9.0	18,045	49,757	67,802	8.6
- Mining and quarrying[b]	5,278	1,920	7,198	5.2	6,153	5,991	12,144	1.8	7,628	4,353	11,981	1.5
- Manufacturing	74	1,248	1,322	1.0	3,522	55,825	59,347	8.9	4,657	70,392	75,049	9.5
- Electricity, water & gas	1,182		1,182	1.0	917	3,481	4,398	0.7	293	845	1,138	0.1
- Construction	15,022	55,689	70,711	50.8	3,071	103,291	106,362	15.9	6,396	108,046	114,442	14.5
- Trade and restaurants	2,130	2,304	4,434	3.1	11,142	91,041	102,183	15.2	16,041	157,884	173,925	22.0
- Transport and communications	3,621	687	4,308	3.1	9,113	12,989	22,102	3.3	13,369	3,798	17,167	2.2
- Finance, real estate, insurance and business service	1,207	731	1,938	1.4	4,573	11,287	15,860	2.4	9,833	6,835	16,668	2.1
- Social and community service	820	2,421	3,241	2.2	7,048	47,878	54,926	8.2	3,071	79,411	82,482	10.5
Total	**40,285**	**67,282**	**107,567**	**77.3**	**65,532**	**372,572**	**438,104**	**65.4**	**79,333**	**481,321**	**560,654**	**71.0**
2. Public administration and defence[c]	25,000	6,507	31,507	22.7	174,448	57,723	232,171	34.6	172,890	56,258	229,148	29.0
Grand total	**65,285**	**73,789**	**139,074**	**100.0**	**239,980**	**430,295**	**670,275**	**100.0**	**252,223**	**537,579**	**789,802**	**100.0**

Notes:

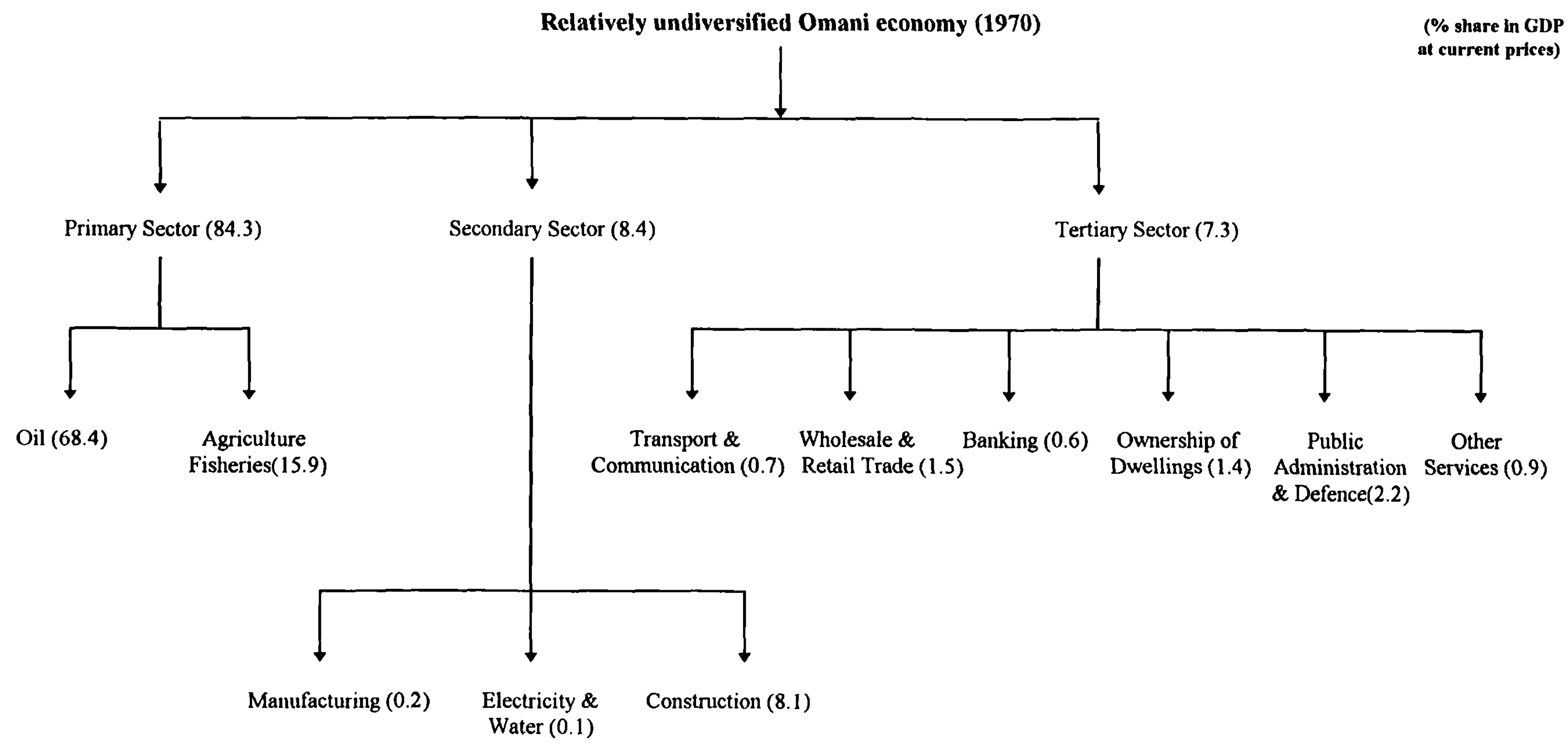
a) The data in this table differs considerably from those published in the Statistical Year Book. These estimates are lower than the published estimates because these are based on the 1993 census results. However, these estimates are in the process of reconciliation with the Ministry of Social Affairs and Labour records.

b) Includes employment in oil sector.

c) Includes people employed in public health and education.

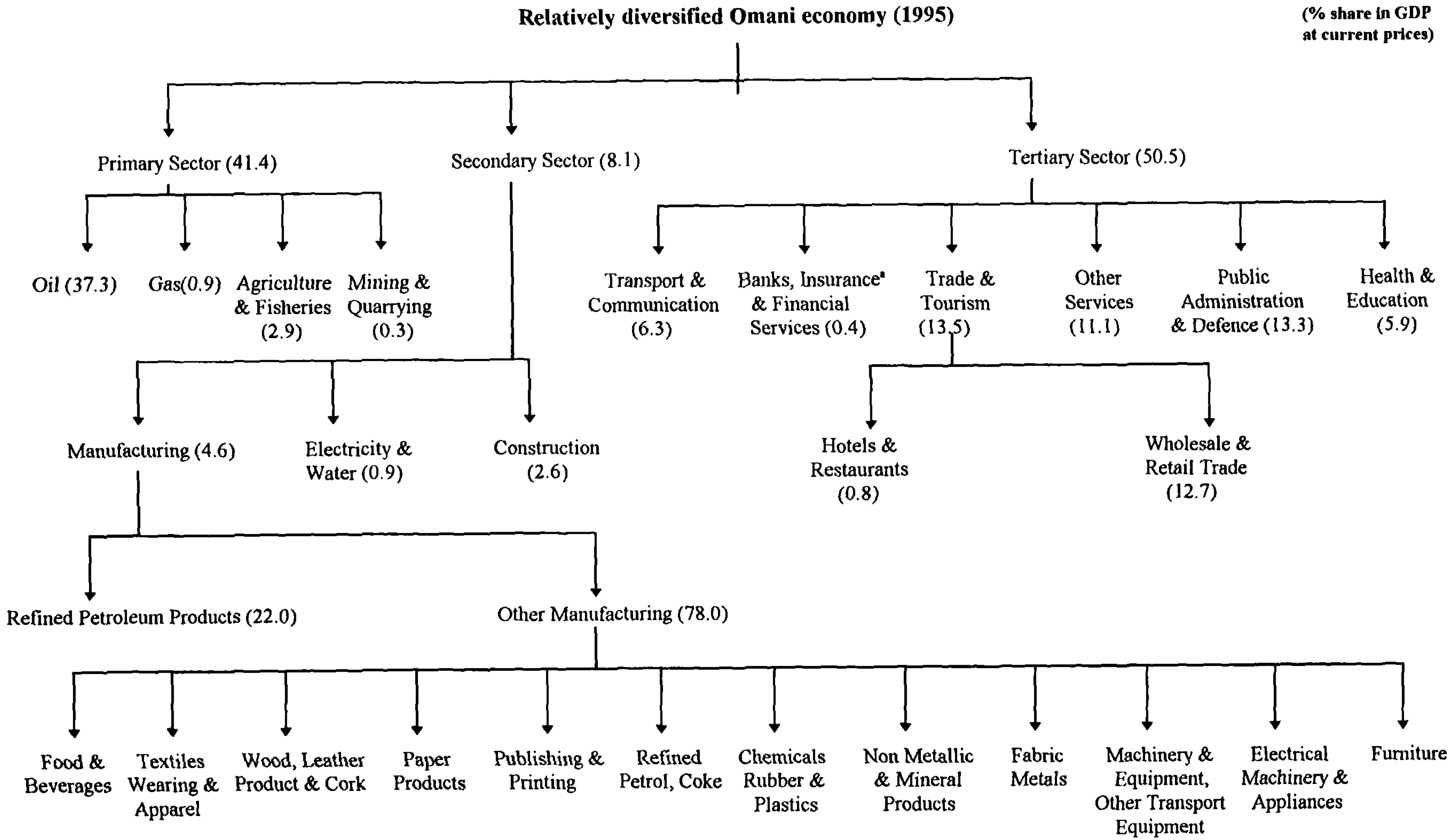
Source: Compiled from the internal data of Ministry of Development.

Chart 7.1



Source: *Statistical Year Book 1985* (Oman, 1986b:p.395).

Chart 7.2



Note: a) Net of financial intermediation services indirectly measured.
Source: *Statistical Year Book 1995* (Oman, 1996b:p.384).

7.3.5 The impact of diversification on trade patterns

The issue of diversification of the economy is related to the question of trade policies and patterns, and the size of the domestic market. As we indicated in Chapter II, one of the arguments put forward by Prebisch[1] (1950) in support of government intervention to promote industrialisation was based on the fact that primary exporting countries faced declining terms of trade *vis-à-vis* the industrial countries[2]. In contrast, for neo-classical theorists, foreign trade can be a propelling force for the development of these economies[3] (Lewis Jr., 1989: pp.1552-57).

As a small country, Oman had no choice but to adopt the neo-classical approach to trade-based development of its primary resource. The successive FYPs (in line with the staple theory of development that we discussed in Chapter II) have placed great emphasis on optimising oil exports by raising the production levels and curtailing domestic consumption on the one hand, and, on the other, creating the necessary linkages between the primary sector and the rest of the economy. However, the performance of Oman's oil exports confirms the argument put forward by Prebisch (1950) that primary producing countries faced declining terms of trade (as indicated above). Whereas, between 1980 and 1995 the volume of oil exports increased from 102 million barrels to 285 million barrels

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[1] As discussed in Chapter II, there were other economists like Singer (1950a and 1950b), Myint (1954), Lewis (1955) and Myrdal (1956) who argued that while the type and extent of trade of each peripheral country with the centre depended largely on its resources, the international political economic relations enlarged the extent to which income was siphoned off by the centre.

[2] This is borne out, for example, by the fact that while the unit value index of exports for petroleum exporters has declined since 1980 by 36 per cent in 1994, for developed market economies' the unit value index of exports has increased by 25 per cent during the same period. Similarly while the unit value index of imports for petroleum exporters like Oman has increased by 21 per cent between 1980 and 1994, for developed market economies the increase was only 10 per cent (UNCTAD, 1994:pp.40-41).

[3] As we recall from Chapters I and II, the neo-classical criticism has been directed mainly against the ISI strategies adopted by developing countries. Using the classical trade theory, the neo-classicals argue that "Smithian trade induced growth is 'trade as the engine of growth par excellence" (Evans, 1989:p.2). Such an argument, as the Marxian and the structuralists contributors have argued, overlooks the role of social and institutional factors. Moreover, they argue that the persistent bias in the terms of trade against primary commodity producers significantly weakens the role of trade as an 'engine of growth'. "Both non-neo-classical and analytical Marxian schools can find common ground in the proposition that trade is the handmaiden rather than the engine of growth" (Evans, 1989:p.283).

(cf. Appendix table 4-AII) representing an increase of 179 per cent, the value of these exports, because of a continuous decline in oil prices[1], increased by only 47 per cent between these two years. As table 7.6 shows, the value of oil exports increased from RO 1,244 million to RO 1,829 million between 1980 and 1995.

Since we have already discussed in Chapters V and VI the policies adopted by the government to manage the effects of export price instability[2] and to promote exports, we will limit our analysis here to two aspects of diversification in trade patterns. These are: the growth of non-oil exports and the direction and composition of non-oil exports.

7.3.5.1 Growth of non-oil exports

In addition to promoting shifts in the sectoral composition of production, demand, public revenues and employment, all successive FYPs have emphasised the objective of diversifying the composition of Oman's exports. The impact of these plans on the pattern of Oman's exports is shown in table 7.6. The value of non-oil exports of locally produced goods increased by 181 per cent, from RO 1 million in 1976 to RO 181 million in 1995, and so their share in total exports increased from 0.2 per cent to 7.8 per cent. Similarly between 1976 and 1995, the share of re-exports in exports increased from 1.1 per cent to 13.8 per cent and their value grew by 54 times (from RO 6 million to RO 322 million). As a result, the share of non-oil exports in total exports has grown from a low level of 1.3 per cent in 1976 to 21.6 per cent of total exports in 1995. Thus, like the production structure, the structure of Oman's exports has undergone significant changes.

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[1] In addition to decline in oil prices in current US dollars between 1980 and 1995, the real price has also continued to decline. Because oil is priced in US dollars, and the value of US dollar, *vis-à-vis* the currencies of other industrial countries has been declining since 1973, the real price of oil has also been declining. Chart 5.1 of Chapter V shows, compared to a price of US$ 20 per barrel in 1996, the equivalent price in 1980 (in 1996 dollars) was more than US$ 60 per barrel.

[2] Academic work analysing the effects of export instability was started with Coppock (1962) and followed by MacBean (1966), Knudsen and Andrew (1975), Hellenier (1986) and Lim (1991). More recently, other studies have attempted to assess the effect of commodity prices or the terms of trade on growth, such as Deaton (1992) and Lutz (1994). David Dawe (1996) provides a new look at the effects of export instability on investment and growth in developing countries.

Table 7.6

Oman's trade structure (1976-95)

(RO Million)

	Items	1976	1980	1985	1990	1995
1.	**Trade balance (2-3)**	**167**	**616**	**555**	**1,042**	**650**
2.	**Exports & re-exports**	**551**	**1,294**	**1,717**	**2,118**	**2,332**
2.1	**Oil exports**	**544**	**1,244**	**1,597**	**1,942**	**1,829**
2.2	**Non-oil exports**	**7**	**50**	**120**	**176**	**503**
2.2.1	Locally produced exports[a]	1	5	23	69	181
2.2.2	Re-exports	6	45	97	107	322
3	**Imports**	**-384**	**-678**	**-1,162**	**-1,076**	**-1,682**
3.1	Recorded	-251	-615	-1,089	-1,031	-1,632
.3.2	Unrecorded	-133	-63	-73	-45	-50
	% of Oil exports to total exports	**98.7**	**96.1**	**93.0**	**91.7**	**78.4**
	% of Non-oil exports to total exports	**1.3**	**3.9**	**7.0**	**8.3**	**21.6**
	Locally produced exports (%)	0.2	0.4	1.4	3.3	7.8
	Re-exports (%)	1.1	3.5	5.6	5.0	13.8

Note:

a) Locally produced exports include all exports of Omani origin, like manufactured goods, agricultural and fisheries produce, other minerals, etc.

Sources: Compiled from Oman (1986b:p.323; 1991b:p.274; 1994c:pp.345-46; and 1996b:pp.275-76) *Statistical Year Book* various issues.

7.3.5.2 Composition and destination of non-oil exports

A small country like Oman with limited domestic markets has to rely on international markets for its exports and imports. Its options for adopting import-substituting industrialisation strategies are therefore quite limited[1]. To overcome the constraints of size, developing countries not only have to promote expansion of the domestic market by creating new economic opportunities but they have also to seek the larger expansion of their markets through regional economic integration. As Lewis

[1] Perkins and Syrquin (1989:pp.1692-1753) provide a useful analysis of the influence that the size of a country has on its policies. "The principal feature that separates very large and large nations from small ones is the negative relationship between country size and the share of foreign trade in gross national product ... Mineral exports, in contrast, have a proportionately much higher share of the exports of small countries" (*ibid.*).

(1984b) and Perkins and Syrquin (1989) have suggested custom unions[1] may allow a small country to enjoy some of the key benefits of large size and thus allow large-scale industries to operate more efficiently.

Thus, Oman's membership of the Gulf Co-operation Council[2] has enabled it to expand its market size and optimise on economies of scale to the extent possible. Moreover, the membership of GCC also acts as a mechanism to promote efficiency in protected industries, since it subjects them to a form of external competition.

Table 7.7 shows the direction and composition of non-oil exports. This shows that Arab countries, particularly the GCC, absorbed the largest share of both locally produced exports as well as re-exports in value terms in 1990 and 1995[3]. The Asian countries have emerged as the second largest market for Omani non-oil exports. Although between 1990 and 1995 the percentage of locally produced goods exported to these markets fell from 23.4 to 21.2, the percentage of re-exports destined for these markets increased from 14.1 to 31.5 respectively during this period. Countries in America (mainly the USA), which absorbed 14.4 per cent of locally produced exports in 1995, compared to 6.1 per cent in 1990, constitute the third largest market for these products. The African region has emerged as the third largest market for Omani re-exports, increasing its share from 5.3 per cent in 1990 to 14.6 per cent in 1995.

In terms of composition of non-oil exports, table 7.7 shows the rising trend in the share of locally produced goods. Although their share in total non-oil exports declined from 39.1 per cent in 1990 to 36.1 per cent in 1995, it nevertheless stood at almost twice the level of 1976. Reflecting the effect of diversification, the composition of exports of

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[1] Customs unions involve the abolition of internal tariffs and the adoption of a common customs tariff (Grimwade, 1996:p.11).

[2] Gulf Co-operation Council was established in 1981 and includes Oman, Saudi Arabia, Kuwait, Bahrain, Qatar and United Arab Emirates. While these countries do not have a custom union, the Economic Agreement between these countries allows free movement of domestically produced commodities — having not less than 40 per cent of local value-added — among member countries.

[3] These shares were 59.7 per cent and 54.9 per cent respectively in 1990 and 57.6 per cent and 46.3 per cent respectively in 1995.

locally produced goods has undergone significant changes as well. While food and live animals made up almost 98 per cent of these goods in 1976, their share declined to only 29 per cent in 1995. In contrast, the share of manufactured goods[1] which was almost zero until 1980, reached 50 per cent in 1995.

Despite the impressive growth of non-oil exports, the share of oil exports, (as table 7.6 shows) remains dominant. At the same time, while Oman's efforts to expand the value of its oil exports have been frustrated by events taking place in the global economy[2], the objective of diversifying and expanding its non-oil exports has been frustrated by internal factors. As discussed in Chapter V, this is due to the government's policy of maintaining low tariffs and an open economy which has promoted competition and kept inflation relatively low. This might have led to efficient allocation of resources in the short-term, but its liberal trade policy and limited protection for infant industries are likely to have an adverse impact on the diversification process in the long-run.

Therefore one of the objectives of the New Development Strategy is to expand the productive capacity of the economy so that imports can be reduced and non-oil exports can be expanded gradually. It is thus projected that the ratio of imports to GDP will decline from 34.5 per cent in 1995 to 20 per cent in 2020. On the other hand, it is expected that the ratio of non-oil exports of Omani origin to GDP will increase from 9.4 per cent in 1995 to 13.0 per cent in 2020 (Oman, 1996a:p.186).

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[1] These include: manufactured goods, machinery and transport equipment, and miscellaneous manufactured goods.

[2] This is because of the continuous decline in the oil price and as a consequence, a decline in its terms of trade.

Table 7.7

Oman : composition and destination of non-oil exports
Relative share in value terms

(per cent)

	1976	1980	1985	1990	1995
1. **Total non-oil exports**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
1.1 **Locally produced**	**18.9**	**9.2**	**19.0**	**39.1**	**36.1**
1.2 **Re-exports**	**81.1**	**90.8**	**81.0**	**60.9**	**63.9**
1.1.1 **Locally produced**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
i) Food and live animals	97.9	98.9	68.3	39.4	28.8
ii) Beverages and tobacco	0.7	0.4	1.7	0.5	1.1
iii) Manufactured goods	-	-	28.7	18.4	24.1
iv) Machinery and transport equipments	-	-	-	-	3.2
v) Miscellaneous manufactured goods	-	-	-	-	22.5
vi) Others	1.4	0.7	1.3	41.7	20.3
1.2.1 **Re-exports**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
i) Food and live animals		5.2	4.6	2.4	3.9
ii) Beverages and tobacco		7.8	0.9	0.3	12.8
iii) Manufactured goods		6.5	4.1	7.2	5.7
iv) Machinery and transport equipment		72.3	68.5	67.6	66.3
v) Miscellaneous manufactured goods		6.2	4.1	10.6	5.5
vi) Others		2.0	17.8	11.9	5.8
1.1.2 **Destination of exports by region (locally produced)**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
i) Arab countries of which				60.5	58.5
a) GCC				59.7	57.6
b) Other Arab countries				0.8	0.9
ii) Africa				0.1	0.7
iii) Asia				23.4	21.2
iv) America				6.1	14.4
v) Western Europe				8.9	5.2
vi) Other countries				1.0	0.0
1.2.2 **Destination of re-exports by region**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
i) Arab countries of which				63.4	48.5
a) GCC countries				54.9	46.3
b) Other Arab Countries				8.5	2.2
ii) Africa				5.3	14.6
iii) Asia				14.1	31.5
iv) America				2.2	1.1
v) Western Europe				13.6	3.4
vi) Other countries				1.4	0.9

Note:
Detailed data for destination of exports (locally produced and re-exports) for the years 1976, 1980 and 1985 are not available.
Source: Compiled from the internal data of the Ministry of Development.

7.4 Private Sector Development and Privatisation

Private sector development is another pillar of Oman's New Development Strategy and Policy. The objective of this strategy is to foster stronger co-operation between the public and private sectors, and to create a dynamic efficient private sector that shall be the main producer of national wealth. Similarly, privatisation is to be undertaken, not as an end in itself, but as a means to achieve economic growth and development objectives. As Martin (1993:pp.1-2) suggests, the state has fundamental and important economic roles, and the effective performance of these roles requires "[t]he development of new approaches to the way the public sectors are run and relate to society and its citizens".

Before examining the objectives and policies that have been formulated to promote the private sector development, we will first review the constraints that Oman faces in this connection.

7.4.1 Constraints facing private sector development

Diversification of the economy and creation of dynamic comparative advantages within the context of an ever changing global economy requires a dynamic and efficient private sector capable of integrating with the world economy in order to enhance national income and employment. To achieve these objectives, the government needs to overcome a number of constraints which have been identified and explained in the Fifth FYP (Oman, 1996a:pp.255-274).

The main ones include the means and manner in which Oman can engage with an increasingly globalised[1] economy particularly in pursuing a large share of the world market.

Second, a reduction in its role in the economy similar to the experience of South Korea, during 1953-1981 (Dutt and Kim, 1994:pp.169-209).

Third, to increase the relative share of the private sector in total investment. This has been growing since 1976, but was still quite low at 35 per cent during 1991-95 (Oman, 1996b:pp.430-431). The aim is to increase this share to 53 per cent during 1996-2000, as envisaged in the Fifth FYP[2] (Oman, 1996a:p.480).

Fourth, during 1976-95, private sector activities have been concentrated mostly in low value-added services which, as noted earlier, contributed almost 50 per cent of nominal GDP in 1995[3] (Oman, 1996b:p.384).

Such a concentration in low-value added activities has resulted in about 84 per cent of private sector firms having in 1995 a capital of less than RO 25,000 and 85 per cent of these firms were in 1993 sole proprietorship[4] in 1995 (Oman, 1996b:pp.228 and 257).

[1] Globalisation can be defined as the increasing interdependence and interconnectedness of national economies and the resulting erosion in the autonomy of nation-states. Globalisation is characterised by an increasing movement of goods, services, capital, ideas and people across national borders; development of regional trading blocs: growth in the number and expansion of global corporations; and a growing number of socio-economic-environmental problems which require co-operation among several countries (Boyer and Drache, 1996:p.274). These authors argue against the notion that globalisation is resulting in a decline of the nation-state.

[2] Appendix table 7-AI shows the breakdown of projected public and private sector GFCF during the Fifth FYP.

[3] As shown in table 6.3 in Chapter VI, 32 per cent of value-added by the private sector in the non-oil sector of the GDP in 1995 has been in trade, hotels and restaurants, 23 per cent in real estate and business services, and only 20 per cent was in agriculture and manufacturing in the same year.

[4] As mentioned in Chapter VI, data on distribution of registered establishments by type of legal entity is being updated. The above data relate to 1993.

Fifth, to create a dynamic and competitive financial sector to reduce dependence of the private sector on soft loans from the government and the specialised banks[1]. At the same time, the low level of domestic credit provided by the banking sector[2] needs to be expanded in order to increase savings and investment and thus enhance the economy's rate of growth. Similarly market capitalisation of the MSM which stood at around 16 per cent of Oman's GDP in 1995[3], needs to be enhanced because stock market liquidity can also encourage private savings and investment.

7.4.2 Policies for promoting private sector development

To overcome the constraints facing Oman in achieving a diversified economy in an era of increasing globalisation, the New Development Strategy aims to combine the promotional and strategic role of the state with the competitive and dynamic nature of the private sector. There are a number of policies which aim at removing these constraints. These include:

Gradual reduction of the government role in production activities and expansion of its role in strategic guidance: to reduce government's role in production activities, a gradual privatisation policy is to be implemented. This policy has two distinct components: a) sale of SOEs and shares owned by the government in publicly listed companies[4]. These would be sold gradually through the MSM in a way which, on the one hand, would ensure the highest return for the treasury, and, on the other, would allow, the maximum number of Omanis to purchase these shares; and b) privatisation[5] of existing public utilities by the granting of franchises to the private sector to build, own and operate

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[1] Oman Development Bank and Oman Agriculture & Fisheries Bank and now the Development Bank of Oman.
[2] This was 29 per cent of GDP in 1995 compared to 132 per cent of GDP in the case of Malaysia and 58 per cent in the case of Chile (World Bank, 1997b:pp.268-69).
[3] As compared to 261 per cent for Malaysia, 121 per cent for Chile, and 40 per cent for South Korea (World Bank, 1997b:pp.240-242).
[4] The Financial Affairs Council is entrusted with establishing the basis and programme for selling-off these assets in a way that would be commensurate with the ability of the private sector and the MSM (Oman, 1996a:p.260)
[5] This process will be undertaken according to the policies and regulations detailed in Appendix 7-AII.

services that are either not being provided by the government, such as sewerage, or are not provided in certain areas. The objectives of the privatisation policy include: enhancing the level and efficiency of public utilities and broadening the coverage of these services to areas that are hitherto unserved; promoting the role of the private sector in the economy and creating suitable opportunities for its growth and expansion; and strengthening domestic inter- and intra-regional linkages.

Upgrading the regulatory framework: this is to be achieved by adopting a "one stop shop" for facilitating the establishment of new projects; converting the Authority for Settlement of Commercial Disputes into a Commercial Court; abolishing the Commercial sponsorship system; revising the Commercial Agencies Law; allowing companies to own land; and reviewing all financial and economic laws to ensure their consistency with the objectives of the New Development Strategy and Policy.

Streamlining the incentive system: to review the entire range of incentives provided to the private sector to ensure their effectiveness and to link these incentives to achievement of specific targets.

Support and develop the financial and banking sector: the policies planned to achieve this objective include: establishing appropriate regulations to commit public and private pension funds to invest in the MSM; encouraging small investors to invest in the MSM; supporting the setting up of investment funds and allowing expatriates to invest in them; streamlining procedures, developing financial transparency and encouraging financial journalism to promote Oman as a financial centre; merging the Oman Development Bank and the Oman Agriculture and Fisheries Bank into one bank and directing the merged bank to concentrate on providing medium-term finance to small and medium companies[1]; transferring the management of government's soft loan schemes for medium and large companies from the Oman Development Bank to commercial banks;

[1] This merger has taken place in March, 1997, and the new bank is called "The Development Bank of Oman" (Oman, 1997:Decree no.18/97).

and encouraging the establishment of a specialised private sector real estate bank to supplement the activities of the Oman Housing Bank.

Other policies: to establish a new port to cater to the growing requirements of the Omani economy and to develop Oman as a regional trading centre; to establish a petrochemical complex; to expand fishing harbours; to deregulate partially the telecommunications sector; and to change the role of the government from a service provider to that of a regulator. Policies relating to HRD, discussed in section 7.5, also have bearing on private sector development.

Private sector development and diversification in a relatively free enterprise economy like Oman are mutually reinforcing. With planned diversification of the Omani economy in the next twenty-five years, and with most of the economic activities to be run by the private sector, it is expected that the role of the private sector in the economy will increase substantially. It is projected, for example, that the ratio of private investment[1] to GDP will increase to 31 per cent by 2020, while that of the public sector will decline to 3 per cent of GDP (Oman, 1996a:p.186).

7.4.3 Dilemmas of privatisation in Oman

Over the years, various interpretations have been associated with the term 'privatisation' (Roth, 1987; Biersteker, 1992; Kikeri, *et al.*, 1992). Kikeri and others have defined privatisation "as the transfer of ownership of SOEs to the private sector by the sale — full or partial — of ongoing concerns or by the sale of assets following liquidation" (*ibid.*:p.14). In its broadest sense, privatisation can be defined as a range of different policy initiatives designed to alter the balance of the public and private sector. It is this concept of privatisation that Oman intends to pursue gradually within its New Development Strategy.

[1] These ratios in 1995 were: 5.0 per cent of GDP for private investment, and 11.1 per cent of GDP for public investment (cf. table 5.2 of Chapter V).

Although privatisation has been adopted within the New Development Strategy as a means to promote growth and efficiency, there are a number of dilemmas that privatisation poses and which need to be addressed. And while some of these dilemmas are a natural response of the society towards the changes envisaged in the role of the state, a number of these dilemmas are similar to the experience of privatisation in a number of other developing countries.

First, while privatisation[1] of SOEs has been promoted by the IFIs because of their poor performance and their lower financial returns compared to private firms (World Bank, 1987), in Oman, as we mentioned in Chapter VI, the returns earned by most of the SOEs, with a few exceptions, are comparable with those of private firms. Therefore, the sale of profitable SOEs would deprive the government of an important source of non-oil revenue. On the other hand, since the private sector will not easily buy loss-making SOEs, the net budgetary burden of supporting the loss making SOEs would rise if only the profit-making SOEs were to be privatised.

Second, the Omanisation of the labour force could suffer as a result of privatisation. Efforts by private owners to maximise profits through staff reductions could retard the drive towards Omanisation.

Third, for the reasons of national interest, enterprises like PDO[2] cannot be privatised. Moreover, the loss of revenue that might occur if PDO is privatised might deprive the state in Oman of the autonomy[3] that is needed to ensure that the new strategies of diversification and private sector development are implemented successfully.

[1] As discussed in Chapters I and II privatisation of SOEs is one of the main elements of the economic liberalisation and market reforms advocated by the World Bank and the IMF.
[2] PDO produces about 92 per cent of oil in Oman, and the government owns 60 per cent of its equity, while foreign multinationals own the rest (Oman, 1996b:p.196)..
[3] As we mentioned in section 3.5.2 of Chapter III, the high degree of autonomy enjoyed by the state during the First FYP was crucial in igniting the development process.

Fourth, 'getting the prices right' has been one of the principal reasons for privatisation. But in the case of infrastructure and public utilities, which are natural monopolies, privatisation may, without state intervention, lead to exploitation of users (World Bank, 1995b:p.28). In Oman, for example, privatisation of electricity has created its own specific problems. Because of the presumed success of privatisation of electric utilities in a number of countries[1], Oman has been investigating the possibility of privatising the electricity sector. However, because most of the functions of maintenance and operation of the power plants, electricity billing and collection, and erection and maintenance of transmission and distribution networks are contracted out to private parties in Oman, it is found that privatisation of the electricity sector would only increase the costs. This is due to a number of reasons though one need mention only two. Firstly the range of efficiencies that could be gained from privatisation have already been achieved through contracting out[2]. Therefore, a change of ownership would not bring any further efficiencies (World Bank, 1995c). Secondly a World Bank study carried out in April 1997 estimated that the private sector would demand an average return of 25 to 30 per cent per annum on its equity for investing in this sector[3]. This is almost 3 times the rate the government pays for its borrowings on the money market.

Notwithstanding the constraints and dilemmas of privatisation, the Omani government has privatised certain activities and divested some of its holdings whenever deemed appropriate. Thus in the Fourth FYP, the government implemented a programme of transferring certain operations of SOEs to the private sector, e.g., collection of telephone bills, street cleaning, maintenance and cleaning of public buildings and so on. Similarly, the government has also divested its entire holding in a few companies, such as Gulf Hotel, Oman National Insurance and Raysut Cement; while a partial sale of

[1] Because of the presumed success of privatisation of electric utilities in UK, Chile and Mexico, electricity privatisation formed about 27 per cent of total value of infrastructure privatisation during 1988-92 in developing countries (*ibid.*: p.151).
[2] A number of studies carried out for comparing the performance of private electric utilities with that of publicly owned utilities have concluded that there is little difference in technical or cost efficiency between public or private ownership and that efficiency depends more on the form of regulation than on the form of ownership (World Bank, 1995c).
[3] This study was carried out for the Omani government.

government holdings in Oman Flour Mill and Oman Cement has taken place. And in order to facilitate the process of privatisation within the framework of its New Development Strategy, the government has established broad policies and regulations to optimise the benefits of privatisation and minimise its negative aspects (cf. Appendix 7-AII).

7.4.4 The role of Fifth FYP in promoting private sector development

The Fifth FYP represents a watershed in Oman's development planning because in the previous four plans the state had led the development process by contributing a major share of capital formation[1] and allocation of resources, the Fifth FYP envisages the introduction of policies which will enable the private sector to assume the lead role in the next phase of Oman's development.

The Fifth FYP, therefore, envisages that the private sector's share of total investment[2], will increase to 53 per cent during 1996-2000 compared to its share of 35 per cent during the Fourth FYP, 1991-95. Thus total private sector investment[3] is likely to reach RO 3,900 million in the Fifth FYP as against an estimated RO 1,344 million in the Fourth FYP. As a result, the ratio of private GFCF to GDP which averaged 5.6 per cent in the Fourth FYP, is expected to increase to 12.2 per cent in the Fifth FYP. In contrast the share of the public sector in total investment is planned to decline to 47 per cent in Fifth FYP from 65 per cent in the Fourth FYP[4] (Oman, 1996a:pp.409-474).

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[1] The government undertook 65 per cent of total investment undertaken during the period 1976-95 (cf. table 5.3, Chapter V).

[2] The terms gross fixed capital formation (GFCF) and investment are used interchangeably here.

[3] Total investment planned during Fifth FYP is RO 7,321 million (public RO 3,421 million; private RO 3,900 million) showing an increase of 90 per cent over the actual total investment in the Fourth FYP (Appendix table 7-AI).

[4] Compared to Oman, in Malaysia, for example, the share of private investment in total investment is projected to rise to 82 per cent in 2000 from 67 per cent in 1990. Consequently the share of public investment declines to 18 per cent in 2000 from a high 33 per cent in 1990 in that country. In absolute terms, total investment in Malaysia is estimated to reach US$ 126.7 billion in 2000 from US$ 38.8 billion in 1990, an increase of nearly 227 per cent during 1990-2000 (Malaysia, 1991:Table 3-3, p.78).

Although the Fifth FYP intends to change radically the ratio of public to private investment, most of the large projects involving private investment in the Fifth FYP have been formulated within its framework and not left to private decisions. Some of these are in the manufacturing sector while others relate to ports, electricity, water and roads. The Liquefied Natural Gas (LNG) project has been conceived as one of the best examples of public-private partnership. Thus, while the state's share in capital formation is going to shrink, its overall responsibility in promoting economic and social development will actually increase.

There are several aspects of the Fifth Plan's investment programme which need to be emphasised. These are: firstly, contrary to the neo-classical theory of "crowding-out" effect of public sector investment, the proposed public investment programme will actually "crowd-in" private investment[1], particularly private foreign investment. Table 7.8 below shows that the government investment of RO 1,427 million in the Liquefied Natural Gas Project is going to induce private foreign investment of RO 928 million. For the oil and gas sector, public investment of RO 2,296 million is going to induce private foreign investment of RO 1,743 million; secondly, the involvement of the foreign private sector in the privatisation programme[2], along with its investment in the oil and gas sector, is envisaged to cover almost the entire savings gap in the Fifth FYP[3]; and thirdly, in pursuing the policy of broadening the private sector participation in the economy, the private sector will be investing for the first time in the gas, electricity and water sectors during the Fifth FYP (cf. Appendix table 7-AI). However, as mentioned earlier, the government has to overcome several problems before privatisation of public utilities can proceed.

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[1] The "crowding-in" effect is one example of the complementarity between public and private sectors. In contrast to the normally assumed "crowding-out" effect, resulting from higher interest rates, the crowding-in effect of public investment, particularly in infrastructure, stimulates private sector investment (Streeten, 1995:p.205).

[2] According to the Fifth FYP, it is estimated that out of an estimated RO 1,008 million privatisation programme, RO 200 million will be invested by the domestic private sector, RO 133 million by the foreign private sector while RO 675 million will be covered by foreign loans (Oman, 1996a:p.328).

[3] Total national savings estimated for the Fifth FYP amount to RO 4,521 million whereas (public and private) planned investment amounts to RO 7,321 million. The savings gap of RO 2,800 million is planned to be met through foreign investment (*ibid.*:p.328).

Table 7.8

Share of public and private foreign investment in oil and gas sectors (1996-2000)

Sectors	Total investment RO Million	Public investment RO Million	Private foreign investment RO Million	Relative share of private foreign investment %
Oil sector	1,684	869	815	48.4
Liquefied Natural Gas project	2,355	1,427	928	39.4
Total	**4,039**	**2,296**	**1,743**	**43.2**

Source: Compiled from Oman's *Fifth FYP*, (1996-2000) (Oman, 1996a:pp.413-481).

As a consequence of the expected increase in the share of the non-oil sectors in GDP to 69 per cent[1] by the year 2000 and the associated growth in private investment, the share of the private sector in total employment is estimated to rise to 74 per cent in the year 2000 as against 68 per cent in 1995 (Oman, 1996a:p.62). The Fifth FYP projections estimate that the private sector will generate 161,000 new jobs during 1996-2000 while the employment in the public sector is expected to decline by about 12,000 jobs (*ibid.*). Thus, the Fifth FYP envisages the private sector making a major contribution in capital formation and employment generation. This represents a re-arrangement of the state-market relationship with the market taking on the function hitherto monopolised by the state. The significant point is that this new re-arrangement is being constructed through a plan, the Fifth FYP.

[1] At 1993 constant prices.

7.5 Human Resource Development[1]

Human Development is the ultimate objective of Oman's 'Vision 2020'. Hence human resource development (HRD) represents one of the four pillars of the New Development Strategy. The new strategy for HRD involves a package of policy measures expected to be implemented over the next 25 years, starting with the Fifth FYP.

7.5.1 Objective of the new HRD strategy

Within the overall objective of the 'Vision 2020', of maintaining and improving living standards, the HRD objective aims at "Development of human resources, upgrading the capabilities and skills of the Omanis to cope efficiently with technological progress and manage the changes that take place within it, and be able to face the ever changing domestic and global circumstances" (Oman, 1996a:p.171).

7.5.2 Policy perspectives of the HRD strategy

While discussing the policy perspectives and parameters of the HRD strategy, it is important to highlight the sub-sectors of HRD. For our analysis, these will include population, health, education, and employment. The policies envisaged in the Fifth FYP for each of these sub-sectors are analysed below (Oman, 1996a:pp.193-220).

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[1] Human development is a much broader concept than HRD. Human development as defined by Streeten (1995:pp.21-22) is "development of the people, for the people and by the people". Human resource development is much limited in scope, in the sense that it aims at productive adults as being the means of production; human resources or human capital (*ibid.*). In the case of Oman, since the long-term development strategy (see Chapter I) treated the individual as both the end objective of development and its means, broadly speaking, the terms "human development" and "human resource development" are used therefore, interchangeably in the case of Oman.

7.5.2.1 Population policy

The objective of the long-term vision is at least to maintain the present real per capita income and work towards doubling it by the year 2020. To achieve this objective a clear population policy is to be formulated immediately to achieve a balance between population and economic growth. The aim is to reduce through persuasion, awareness and information campaigns[1] the present high annual rate of population growth (estimated at 3.7 per cent) to less than 3 per cent.

7.5.2.2 Policies for health

In recent years, the production, distribution, and consumption of health services have been viewed as analogous to those of any other commodities. Thus the neo-liberals argue that it is best to allow supply of even health care to be guided by prices established in a free market. The main recommendation is that user fees should be charged for all services unless a specific market failure can be shown to exist (Bloom, 1991:p.318). However, while the neo-liberal case is unconvincing because a number of factors make health care quite unlike a typical commodity[2], the value of which can be ideally established in the market, this issue has stimulated the ongoing debate about the most appropriate way to fund the health sector. Based on detailed studies conducted to formulate a long-term health strategy, a number of policies have been adopted to achieve the objectives of providing essential public health services[3] to all Omanis at no cost, while avoiding misuse, wastage and inefficiency.

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[1] For example, the Ministry of Health has recently launched a birth-spacing programme which no doubt will contribute towards reduction of population growth.

[2] Among these, the two important factors are: demand for health care is for most buyers perfectly inelastic and though the products supplied are highly differentiated (varieties of therapy and medicines), buyers therefore neither have any knowledge of the differences in products supplied nor have they any choice in selection of quality/kind of product which is decided by doctors.

[3] Primary health care, preventive care and emergency services will be provided free of charge to all Omanis. This is in line with the 1978 *Alma Ata Declaration* on public health care (*ibid.*:p.215).

The policy perspective on health care also emphasises upgrading of medical facilities and improving referral services. And in order to create employment opportunities for the Omani labour force in the health sector, the Ministry of Health is expected to enhance the capacity of various training institutes.

In terms of funding the health sector within the constraints placed on government budgets, there is an official move towards partial self-financing of medical facilities for Omanis. It is proposed that the government should charge RO 5 annually on each health card[1] as of 1 January, 1996 and this should be increased to RO 10 by 1998 in case a health insurance scheme is not operative[2]. These charges are expected to meet 10 per cent of the health sector budget by the year 2000 and 50 per cent by the year 2020. Moreover, in order to foster the role of the private sector, it is intended to provide it with long-term concessional loans to set up and/or upgrade private medical facilities, and it is further intended that the government should procure health services from the private sector, whenever it is economically feasible.

7.5.2.3 Education policy

Provision for education has remained an important area of state action for reasons of equity, efficiency, potential market failure and externalities. Similarly, upgrading the skills and capabilities of the labour force improves a nation's competitiveness which is very important in a world moving towards globalisation and increased international competition.

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[1] At present, each Omani has a health card which provides him access to all medical facilities. The fee for the card is 100 baizas (1/10th of one Rial). Treatment and medicines are provided free of charge. The cabinet, based on recommendations of the Ministry of Health, has decided to reduce the health card fee to RO 1 and introduce a fee of 500 baizas for each visit to the doctor with effect from January, 1996. The visit fee has been introduced to reduce the number of out-patient visits an Omani makes to the doctor annually, because it was found that on an average the number of visits per patient is far higher than the world average. People on social welfare will be exempt from these fees (Oman, 1996a:p.199).

[2] The Ministry of Health is to carry out a detailed study about introducing health insurance in Oman. It is proposed that once health insurance is introduced, all user fees will be abolished.

However, in view of the budgetary constraints, and the need to generate additional resources for investment in education and training, Oman, like many developing countries, has to devise alternative strategies to fund investment in this area. The formulation of official policies aims at (i) maintaining the government's commitment to provide of free basic education to all; and (ii) encouraging private sector participation and cost sharing in vocational training and higher education.

The main thrust of the new educational policies is, therefore, to upgrade the present general education curricula for Omanis and modernise them to a level comparable with best practices available in the world. Similarly, it is planned to restructure the existing technical and vocational training systems[1]. As UNDP (1996) states, "Without basic literacy and numeracy people's ability to adapt to changing production methods and technologies is severely constrained" (p.105). Similarly, the policy intends to continue providing equal access to education for all, to promote equitable distribution of job opportunities and thereby ensure economic empowerment of all.

Equally important within the context of such restructuring is the question of selecting an appropriate balance between education and vocational training to meet the highly diversified requirements of the labour market. In allocating resources, it is therefore, proposed to provide free basic education for 10 years, while secondary[2] education ranging between 2 to 3 years will be funded to the extent of 70 per cent by the government. Again for post secondary education, university level education at Sultan Qaboos University will continue to be provided free, while the state would fund a maximum of 70 per cent of the cost of all post secondary education provided at private colleges or institutes (Oman, 1996a:pp.194-220).

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[1] It is proposed to adopt the British General National Vocational Qualifications (GNVQs) for technical education and the British National Vocational Qualifications (NVQs) for vocational training after suitably adapting them for the Omani labour market.

[2] There will be two streams for secondary education. General secondary which will be for 2 years and technical secondary whose duration will range between 2-3 years (*ibid.*).

7.5.2.4 Role of the private sector in Oman's new HRD strategy

The new HRD strategy envisages a stronger public-private partnership in the field of education and training. In order to expand private sector's role in the provision of education and training, it is proposed to provide long-term concessionary loans to the private sector to set up or upgrade schools, institutes and colleges. Moreover, to further expand the concept of private delivery and public funding, it is envisaged that the government will not increase the number of secondary level schools, vocational training institutes and higher educational colleges. Instead it will provide the students with a grant, covering about 70 per cent of the tuition fees, to enrol in private institutions (Oman, 1996a:p.201).

In order to maintain high standards of education and training, the government shall institute necessary regulations to monitor implementation of those standards, quality of delivery in private schools and institutions, and the provision of grants to students.

For generating employment for Omanis, it is intended to place stronger emphasis on technical education and vocational training and linking the level and type of education and training with the demands of the labour market. There will be a closer relationship with the private sector to achieve these goals.

At the same time, in order to bring the actual cost of employing expatriate labour closer to its real economic cost, it is intended to increase the minimum annual labour levy from RO 60 per person to RO 120[1] per person from 1996 onwards. The revenues generated from this levy will be allocated solely for implementing the new human resources development strategies.

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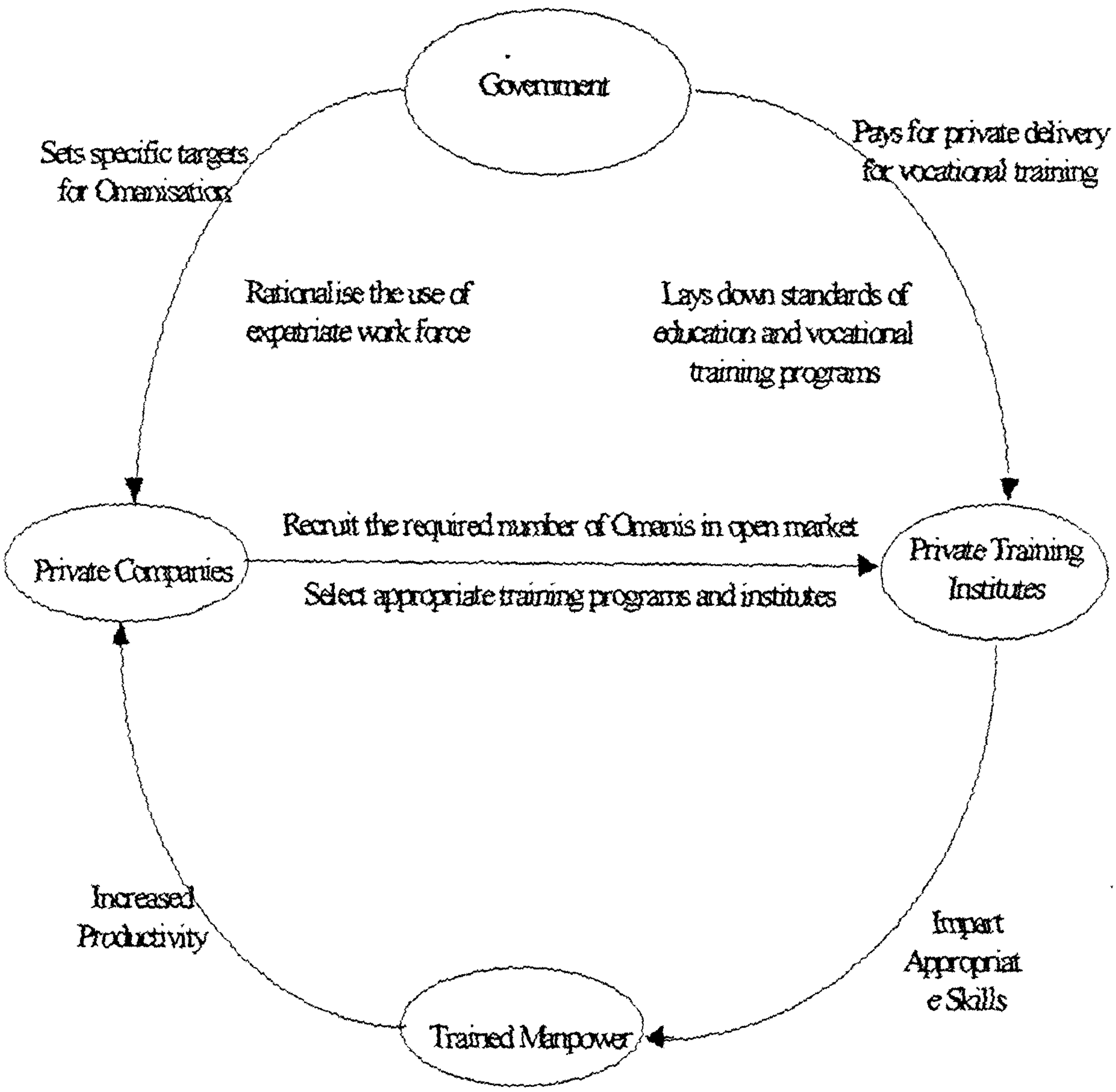
[1] The cabinet has subsequently decided to defer the increase to 1.1.98 and to reduce the increase to RO 30, so that the labour levy becomes RO 90 as a minimum (*ibid.*:p.212).

In order to commit the private sector to employ Omanis, the government has laid down specific targets[1] for the level of Omanisation that each private company must achieve within a given time frame. Moreover, each company must submit a training programme to the ministry concerned to demonstrate its commitment towards achieving Omanisation targets. Fines would be levied in case of non-compliance. Chart 7.3 below illustrates the policy framework through which the government intends to promote an active public-private partnership to promote Omanisation.

[1] These targets have been set on the basis of estimated output of the education and vocational training systems and the present stock of unemployed persons.

Chart 7.3

Public-private partnership in the HRD strategy



Source: Compiled from the *Fifth FYP* (Oman, 1996a:pp.194-220).

7.6 Provision of a Stable Macroeconomic Framework

In view of the importance of macroeconomic stability for promoting diversification and private sector development, the New Development Strategy aims to further reinforce the policies that have been adopted for this purpose over the last two decades. Along with diversification of the economy, private sector development and privatisation and HRD, the 'Vision 2020' aims at: "Provision of a stable macroeconomic framework, including the achievement of financial equilibrium in the State General Budget; avoidance of inflationary pressures, and working towards stabilising the nominal exchange rate of the Omani Rial and maintaining its convertibility" (Oman, 1996a:p.171).

7.6.1 Achieving a balanced budget

It is planned to achieve a balanced budget by the last year of the Fifth FYP (2000) and work towards generating annual budgetary surpluses thereafter to the extent of 3 per cent of GDP. The main measures which are designed to realise this policy objective include: a) strengthening fiscal discipline by legislating that the annual state budget must strictly conform to the fiscal framework of FYPs; b) funding all expenditures above approved budgets from the general revenues of the state without resorting to public financial reserves (mainly the SGRF) or to public borrowings; c) stringency in ministries and departments; and d) gradual government withdrawal from provision of public utilities (electricity, water, posts, telecommunications, etc.) and provision of these services by the private sector where this is possible.

In addition to the above, the new policies aim to diversify and increase non-oil revenues, so that by the year 2020, these contribute at least 60 per cent of total government revenues compared to their present share of 25 per cent. It is planned to raise the share of non-oil revenues[1] through imposition of new fees, new taxes, raising rates of existing taxes, and streamlining the system of tax collection.

7.6.2 Promoting public savings and building financial reserves

There are a number of measures planned within the Fifth FYP for raising the level of public savings and enhancing financial reserves. The main ones include transferring to the SGRF all oil revenues realised above the price of US$ 15 per barrel and up to US$ 17 per barrel as a minimum; transferring to the SGRF all proceeds realised from sale and/or privatisation of public assets; and freezing public debt, both external and internal, at the level of RO 1,500 million[2].

7.7 The Future Role of the State

The role of the state in Oman's development has been described and analysed. An important question which now arises is: what should be the role of the state in Oman under the New Development Strategy? The World Bank, for example, has suggested in its report on Oman that the role of the government should be curtailed and development planning should be limited to a three year economic plan (World Bank, 1994a). In contrast, we have argued that the role of development planning and of government should be strengthened; otherwise it is possible that the gains and the momentum of development may be jeopardised.

When one looks, for example, at the large saving gap of RO 2,800 million in the Fifth FYP, representing almost 38 per cent of the total investment required, it is clear that such a gap can be handled only within a medium- to long-term perspective. In order to finance this large gap, the state alone is capable of ensuring that macroeconomic stability is maintained, adequate physical infrastructure exists for investment activity and the

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[1] It is also expected that with the growth of the SGRF assets and revenues, the fund will be able to support non-oil public revenues when oil revenues start to decline gradually in the next century.

[2] Public debt as we noted in Chapter IV, stood at this level at the end of 1995.

regulatory framework and political and social stability remain conducive for private sector investment.

Since an important part of the diversification programme is based on the development of gas based industries, which will require substantial foreign investment and technology, direct involvement of the state is equally important for a number of reasons[1]. First, since gas is owned by the state on behalf of the society, it has to negotiate with foreign investors to maximise the economic rent; second it has to ensure that adequate financial resources are allocated for the supporting infrastructure[2]; and third, the selection of appropriate technology and the necessity of creating backward and forward linkages require government intervention, because only the government can take a long-term view for the benefit of society.

In order to promote an export-led diversification, the state has to take a much more direct role in guiding the process. The state's involvement is not only necessary to conduct negotiations with the World Trade Organisation (WTO), but also to provide direct support to Omani industries to be able to compete in overseas markets. As Palan, *et al.* (1996:p.63) state, the new trade theorists like Reich, Krugman and Zysman have argued that in reality the global market does not match the perfect conditions of the neo-classical rationale, "[a]nd that political intervention can actually create comparative advantage, or as Porter succinctly describes it, competitive advantage" (*ibid.*). The state's role should therefore be to facilitate the process of globalisation. Moreover, in view of Oman's extremely liberal trade policy, as indicated by its low tariffs and freely convertible currency, state intervention in achieving the objectives of the New Development Strategy is even more justified.

[1] These are in line with Evans' (1985:p.195) argument that transnational capital may, under certain circumstances, prefer dealing with a "stronger", more bureaucratically capable state apparatus. And that the challenges of dealing with MNCs "[m]ay legitimate the expansion of the state's role into areas that would otherwise be the preserve of private capital" (*ibid.*).

[2] This includes gas exploration and drilling, laying of pipelines for transportation of gas and so on.

Last, but not the least, enhancing the role of the private sector in the process of diversification, warrants an even more effective role for the government in guiding and assisting it to achieve the desired objectives. What is required is to form a strategic alliance between the government and the private sector, in the form of 'Oman Incorporated', as is recommended in the Fifth FYP (Oman, 1996a:p.258). In the Fifth FYP, the state's role will therefore, shift to providing strategic guidance, monitoring and promoting a broad-based development process[1].

In the case of privatisation, the state has the responsibility of managing the process, but it has also to ensure that it actually promotes efficiency and competition. This is particularly true in the case of natural monopolies such as electricity and water where the state has to ensure that all privatisation policies and regulations are adhered to and that appropriate regulatory policies are in place. "Nowhere is the changing role of government and the increasing reliance on market-based regulatory policies more evident than in the telecommunications and electricity industries" (Stiglitz, 1996:p.21). In many small developing countries like Oman, as Biersteker (1992:p.205) argues, where the public sector can support a limited number of enterprises, the private sector is not likely to be any more efficient than the public sector. The government has therefore to look at alternative

[1] In order to emphasise the significance of the state's role in providing strategic guidance for directing the industrialisation process, it is worthwhile to note here Japanese government's views on industrialisation. This was expressed by former Vice Minister Ojimi as follows: The MITI decided to establish in Japan industries which require intensive employment of capital and technology, industries that in consideration of comparative cost of production should be the most inappropriate for Japan, industries such as steel, oil refining, petro-chemicals, automobiles, aircraft, industrial machinery of all sorts, and electronics, including electronic computers. From a short run, static viewpoint, encouragement of such industries would seem to conflict with economic rationalism. But, from a long-range viewpoint, these are precisely the industries where income elasticity of demand is high, technological progress is rapid and labour productivity rises fast. It was clear that without these industries it would be difficult to employ a population of 100 million and raise their standard of living to that of Europe and America with light industries alone; whether right or wrong, Japan had to have these heavy and chemical industries. According to Napoleon and Clauseqitz, the secret of a successful strategy is the concentration of fighting power on the main battle grounds; fortunately, owing to good luck and wisdom spawned by necessity, Japan has been able to concentrate its scant capital in strategic industries (Singh, 1991:p.41).

ways of increasing efficiency of the public sector and expanding the service to the consumers[1].

Finally, as we have suggested, privatisation on its own will not lead to a broad-based private sector development. For privatisation to succeed it has to form a part of the whole package of measures aimed at regulatory and market reform, and liberalisation. Moreover, it should not be undertaken as an end in itself but as a means of achieving wider developmental objectives.

7.8 *Conclusion*

This chapter has described some of the major components of the New Development Strategy and Policy in Oman which attempt to deal with the three main problems that constrain further development of Oman. That is, diversification, private sector development and human resource development. In all these spheres, the role of the state, as well as the private sector, in meeting the objectives of the New Policy, is to continue to work in a complementary but changed manner. Because, as we have argued, the state has fundamental economic and social roles, and as development progresses, the state has to devise new policy approaches for the effective performance of these roles. It has been argued that on completion of the New Development Strategy in 2020 the role of the state is not likely to shrink but will certainly undergo a dramatic change. The state's role is therefore likely to shift from control to regulation of Oman's economy and society, though without completely relinquishing the former while taking over the latter. Hence, in some ways the state will continue to be the overall protector and guardian of the country's economy.

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[1] This can be done, for example, by leasing of power plants instead of privatising generation, or by corporatising. "Privatisation represents only one point along a spectrum of organisational forms that include a variety of corporatisation structures within the public sector" (Stiglitz, *op. cit.*, 1996:p.20).

Appendix table 7-AI

Sectoral distribution of public and private gross fixed capital formation (GFCF) (1991-2000)

(RO Million)

Fourth FYP (1991-1995)				Fifth FYP (1996-2000)								
				Public sector					Private sector			Total GFCF
Public sector	Private sector	Total	Sectors	Civil Ministries	HRD[a]	SOE	LNG project	Public Total	Privatisation programme	Other private	Private Total	
975.2	**821.9**	1797.0	**Goods production sector**	**80.0**	**0.0**	938.0	**1,427.0**	**2,445.0**	**2,75.0**	**2291.0**	**2566.0**	**5011.0**
738.9	618.7	**1357.5**	Crude oil	1.4	-	865	-	866.4	-	815.0	815.0	1681.4
151.0	0.0	**151.0**	Natural gas	35.0	-	42	1,427	1504	-	928.0	928.0	2432.0
6.8	0.0	**6.8**	Mineral and quarries	1.8	-	-	-	1.8	-	8.1	8.1	9.9
43.1	32.9	**76.0**	Agriculture	8.4	-	-	-	8.4	-	48.3	48.3	56.7
7.5	13.8	**21.3**	Fisheries	20.5	-	-	-	20.5	-	24.1	24.1	44.6
28.0	134.6	**162.5**	Manufacturing	12.9	-	31.0	-	43.9	275.0	301.0	576.0	619.9
0.0	21.9	**21.9**	Contracting	0.0	-	-	-	0.0	-	166.5	166.5	166.5
468.5	**522.5**	**991.1**	**Services sector**	**226.0**	-	**109.0**	**0.0**	**335.0**	**608.0**	**570.0**	**1178.0**	**1513.0**
53.3	394.5	**447.9**	Housing	16.2	-	-	-	16.2	-	371.1	371.1	387.3
18.2	64.6	**82.9**	Trade	0.5	-	-	-	0.5	-	86.3	86.3	86.3
164.0	0.0	**164.0**	Electricity	160.5	-	-	-	160.5	376.0	-	-	536.5
115.4	0.0	**115.4**	Water	44.7	-	-	-	44.7	232.0	-	-	276.7
117.6	0.0	**117.6**	Post, telegraph and telephone	2.0	-	109.0	-	111.0	-	-	-	111.0
-	-	-	Tourism	2.1	-	-	-	2.1	-	20.7	20.7	22.8
0.0	34.4	**34.4**	Transport	-	-	-	-	0.0	-	31.0	31.0	31.0
0.0	28.9	**28.9**	Financial and banking institution	-	-	-	-	0.0	-	60.9	60.9	60.9
298.9	**0.0**	**298.9**	**Social sector**	**131.0**	**269.0**	**0.0**	**0.0**	**400.0**	**0.0**	**31.0**	**31.0**	**431.0**
108.4	0.0	**108.4**	Education	64.3	157.2	-	-	221.5	-	8.0	8.0	229.5
7.7	0.0	**7.7**	Vocational training	5.6	98.9	-	-	104.5	-	9.2	9.2	113.7
92.0	0.0	**92.0**	Health	33.3	12.9	-	-	46.2	-	8.0	8.0	54.2
62.7	0.0	**62.7**	Information and culture	18.8	-	-	-	18.8	-	2.3	2.3	21.1
{28.1	0.0	**28.1**	Social and youth centres	9.0	-	-	-	9.0	-	3.5	3.5	12.5
770.3	**0.0**	**770.3**	**Infrastructure sector**	**238.0**	**3.0**	-	**0.0**	**241.0**	**125.0**	**0.0**	**125.0**	**366.0**
118.9	0.0	**118.9**	Roads	45.9	-	-	-	45.9	62.0	-	62.0	107.9
24.4	0.0	**24.4**	Airports	6.1	-	-	-	6.1	-	-	0.0	6.1
20.4	0.0	**20.4**	Ports	2.6	-	-	-	2.6	-	-	0.0	2.6
86.7	0.0	**86.7**	Irrigation and water resources	34.3	-	-	-	34.3	-	-	0.0	34.3
126.9	0.0	**126.9**	Town planning and municipal services	33.6	-	-	-	33.6	63.0	-	63.0	96.6
393.0	0.0	**393.0**	Government administration	112.8	3.0	-	-	115.8	-	-	0.0	115.8
-	-	-	Environment and pollution control.	2.7	-	-	-	2.7	-	-	0.0	2.7
2,512.9	**1,344.4**	**3,857.3**	**Total**	675.0	272.0	1,047.0	1,427.0	3,421.0	**1,008.0**	**2,892.0**	**3,900.0**	**7,321.0**

Note: a) This is a special programme to implement the new HRD policy. It is in addition to the allocations included for HRD under the social sector.

Source: *Fifth Five Year Plan,* Oman (1996a:p.480).

ROYAL DECREE NO. 42/96 issued on June 8, 1996 (Oman, 1996h)

Policies of Privatisation

1. Privatisation represents a part of the government programme aimed at achieving sustainable development, increasing growth rates and distributing the benefits of development among all regions and segment of the society.

2. Priority of privatisation shall be given to services that operate on a commercial basis, such as wastewater, electricity, water, telecommunications, highways and postal services. When privatising these services, consideration shall be given to the financial and administrative capacities of the private sector.

3. In order to ensure that any changes in the economic and social situation are made in a measured and gradual manner, privatisation shall be applied gradually to the existing governmental production and services enterprises.

4. Transparent and explicit criteria shall be set for the selection and evaluation of privatisation proposals; in addition clear identification of the responsibilities of the concerned government authorities and for the system of improving the system of monitoring the privatisation programmes shall be laid down.

5. More than one company shall be established to render a service, whenever possible, in order to increase competition and enable the government to compare the performance and efficiency of the service providers.

6. The government shall determine the unified maximum tariff to be paid by all consumers in the Sultanate, regardless whether the project is operated by the government or by the private sector. The tariff shall not be amended without government approval.

7. To benefit from foreign capital and technical and administrative expertise, foreign participation in the privatisation projects shall be encouraged; such participation should be in accordance with the Foreign Investment Law.

8. The government shall set the regulations and standards for protecting the environment from any negative impact that may arise, after privatisation of certain sectors, as a result of the efforts of the privatised enterprises to reduce cost.

Appendix 7-AII contd...

9. The government, through the use of various means of mass media, shall prepare the society to accept forthcoming changes in the economic and industrial structure of the country, by elaborating the advantages of privatisation to the members of the society, its importance to their prosperity, particularly to the fixed-income group, and its contribution to the comprehensive development process.

10. The sale proceeds of government assets in the privatised production and service projects, shall accrue to the State general Reserve Fund.

Regulations of Privatisation

1. The selection of the company best suited to finance, implement and operate the project, shall be determined through open tender, for which maximum number of Omani companies shall be invited.

2. The selected company shall take the form of a joint stock company with Omani participation being not less than 51 per cent. At least 40 per cent of the equity shall be floated for public subscription.

3. Companies established for privatisation projects shall be treated as Omani companies for tax purposes.

4. Companies established for privatisation projects, where the government does not guarantee to purchase all or part of their output, shall be treated as industrial companies for the purpose of taxation and custom duties.

5. All profits exceeding an average of 20 per cent — over a period of three years — of the paid up capital of the company holding a government franchise[1] shall be shared with the government.

6. No soft loans or interest free loans shall generally be extended to privatisation projects by the government, exceptions if any, shall be kept to the minimum.

[1] That is, companies established for privatisation projects.

7. The government shall set the appropriate level of standards and specifications for all privatised projects; and all companies should be committed to apply such standards and specifications while implementing, managing and operating these projects.

8. Implementation, operation and management of privatised projects shall be in accordance with the performance and efficiency criteria specified by the government.

9. To the extent possible, employees currently working in production and services projects to be privatised shall be transferred to the project company.

10. In the case of submission of equal bids by the investment consortia, and in order to broaden the investor's base in privatised projects, preference may be given to the consortia that have not been awarded any other privatisation projects.

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CHAPTER VIII

SUMMARY AND CONCLUSION

8.1 Introduction

Our research has analysed the role of the state, through planning and the market, in securing development in Oman. This process itself has been shaped by a range of institutional, ecological, historical, political and ideological factors prevalent in the country and at an international level. A crucial element in this process has been the conscious effort by the state to fashion an individual development path for Oman by creating a number of institutions and formulating plans and policies which have been able to tackle issues and problems that are specific to the country. As we have shown, an important characteristic of these policies has been to secure development which includes both economic growth and distribution of social welfare. An assessment of the synergetic working of the plan and the market in this process has been another element in our study. Our analyses indicate the necessity of a continued role for the state in the economic and social transformation of Oman, and other things being equal, for other developing countries as well. Though of course this role is not static and may change to meet new demands and challenges (Waterston, 1982; Urrutia and Yukawa, 1988).

In Oman, as we have seen, the primary role of the state has been to ensure that scarce resources — particularly revenues from oil — are channelled to the most useful and desirable purposes, i.e. promoting economic development and social welfare. The thesis has shown that the role of planning and market in meeting these objectives has been complementary rather than antagonistic. In this context there are two main objectives of this chapter. Firstly, to provide a summary of our study, and secondly, to reflect on the question of how the state and market in Oman can complement each other in furthering economic and social development in the future.

Our study has shown that prior to 1970 Oman was a poor and underdeveloped country. The mainstay of the economy was agriculture and fisheries and trade based largely on these (Speece, 1989; Al Yousef, 1995). In 1964 oil was discovered and in 1967 it began to be extracted on a commercial basis for exports. However, from 1970 when the present Sultan, H. M. Qaboos bin Said, assumed power development started in earnest in Oman. A number of institutions were established to facilitate and co-ordinate the development process with financial resources provided by oil revenues.

There are two main characteristics of Oman's development policies and strategies which have been executed through the FYPs. Firstly, these emphasised economic growth and social welfare. In many other developing countries high rates of growth had not translated into increased welfare — the benefits of growth had not trickled down. In Oman this situation was avoided through policies and institutions specifically designed to ensure that growth in the economy was accompanied by improvement in social welfare.

The second major characteristic has been the combination of plan and the market, that is, the state and the private sector, to secure economic and social development. Where the market was weak or absent, the state through allocation of investible funds via the FYPs, has fostered or developed this. In other words, rather than being a pure choice between market and state it has usually been a choice between different combinations of the two, and different degrees of one or another mode of allocating resources.

8.2 The Context

When Oman's development process commenced in an organised and systematic manner in 1976 it had to negotiate three main contexts or situations. These were, the initial socio-economic conditions in Oman; the nature of oil as a major revenue earner; and the international political economy comprising ideology and politics of development.

Firstly, the initial socio-economic conditions and infrastructure were extremely underdeveloped even compared with other developing countries. Not having been colonised (probably because prior to the discovery of oil the country had no significant exploitable resources as in the colonised countries) the country lacked the basic necessities of roads, ports, airports, electricity and water, health and education and other essential socio-economic infrastructure and institutions which other developing countries possessed. The state in Oman had therefore to undertake, on the one hand, the development of its primary produce, oil, and, on the other, to use the resources generated from it to launch comprehensive and effective investment programmes. Thus a considerable proportion of Oman's oil revenues went towards constructing basic infrastructure (Skeet, 1992; Al Yousef, 1995). The second context that Oman's planning had to negotiate is related to the nature of oil as an export commodity. The price of oil fluctuated, sometimes drastically, which affected the implementation of plans and often required a re-arrangement of sectoral priorities. Related to this process is the movement in Oman's terms of trade. While in the short-term these could be favourable, in the long run there was a secular decline in these against Oman.

However, inspite of fluctuations and instability of oil revenues, expenditure on social welfare was not cut. In this Oman stands out. The usual scenario is a reduction in expenditure on social welfare when there is a need for austerity.

Given that the price of oil, and hence revenues, fluctuated significantly, it was necessary to establish a mechanism to provide a buffer against these to prevent disruption in the funding of development. Thus the State General Reserve Fund was set up in 1980 as a facilitating institution to work in conjunction with development planning.

The third aspect is the context in which development planning in Oman was located in 1976. This was the ideological and political context of development thought prevailing in the late 1960s, which was strongly critical of the role the state had played in development, but from two opposing perspectives (Wade, 1990). This critique was related to the serious side-effects of development in the developing countries which began to surface in the 1970s: increase in relative and absolute poverty, unequal distribution of income, and lack of other aspects of development such as health, education, employment, and so on.

From the perspective of what may be called the progressive theorists that include Seers, Streeten and Ul Haq, the state needed to develop mechanisms to ensure the distributional aspects of development. The state therefore had to expand its intervention in the economy and society to meet basic needs of the population. The concept of (and obsession with) growth rates and per capita income needed to be replaced by a multi-dimensional concept of development which comprised both growth and social welfare. The opposing view, espoused by the IFIs and many influential neo-classicist thinkers such as Bauer and Lal, among others, was that the role of the state should be minimal if not absent from the functioning of the economy, and that development planning should be abandoned in favour of the market mechanism as an alternative for allocating resources in a rational manner. This would increase economic activity which in turn would reduce poverty, increase productivity, employment, and so on. Furthermore, the imputed role of private enterprise in South Korean and Taiwanese development, by ignoring the special relationships the former had with the developed countries (Nazir, 1991) provided additional justification for a minimal state.

In this context it must be stated that the process of planning for development in Oman posed much greater problems than in Korea and Taiwan. In Korea as we have stated in earlier chapters, a relatively well-developed infrastructure as well as a highly skilled population were in place at the start of its development planning, especially in the early 1960s. The reasons were the nature of Japanese colonial rule and the massive allocation of resources by the USA in building South Korea as a bulwark against communism (Nazir, 1991). Also crucially important was the fact that Korean development was financed in later phases by export of manufactured goods, especially textiles. At that time (1950s and 1960s) there was relatively little global competition for these and these were not subjected to the declining as well as volatile terms of trade that Oman had to negotiate with its sole export of a primary commodity, oil. In addition in Korea it was only from its Fifth FYP (1980s) that welfare aspects of Korean development came to be addressed in a systematic manner (Dutt and Kim, 1994). In contrast, as we have analysed, in Oman, social welfare was a more important component of development planning when this commenced in the 1970s.

Be that as it may, it was not only the economic and social structure which constrained Oman's development. When Oman began its development planning the intellectual and political environment was also hostile to state intervention in the economy in general, and to development planning in particular. In fact by the late 1970s and the early 1980s with the coming to power in the UK and the USA of conservative administrations and the emergence of the debt crisis of the early 1980s, the concern for basic needs was tacitly buried, and the emphasis shifted to SAPs. These programmes, in essence were a disguise for the neo-classical policy approach which was dormant during the 1950s and 1960s and concentrated then more on efficiency and fiscal aspects of the economy. However, a major criticism that was directed against the SAPs was that the distributional aspect remained more or less neglected. This is not to say that those who support these programmes (such as the World Bank) ignored the need to eliminate poverty; rather it was the strategy on how to alleviate poverty that changed. The emphasis in SAPs[1] is on increasing productivity of the poor, with government concentrating on liberalising the economy and providing the minimum services required to conduct private business efficiently and to protect society's weakest members (UNRISD, 1995). The

[1] However, as a result of a number of empirical studies carried out (most notably the 1987 UNICEF Study (Cornia, *et al.*, 1987)) which have proved the serious human cost of the SAPs, the World Bank and the IMF have since the early 1990s, been changing the content and scope of these SAPs (World Bank, 1990; UNRISD, 1995).

expectation is that by "getting the prices right" the invisible hand of the market will promote social welfare and equitable distribution of income. As the *Human Development Report* (UNDP, 1996:p.49) states, "During this whole process of liberalisation, adjustment and privatisation, concern for the poor was pushed into the background".

It is apparent from our study that Oman learnt from the shortcomings of the planning and development strategies of other developing countries and incorporated various policies, strategies and mechanisms aimed at minimising the negative aspects of development planning experienced in these countries. Firstly, there was a firm and serious political commitment of the state to development. There was no window dressing, cosmetic or propagandist gestures to appease or placate hostile or favourable opinion. The government in Oman itself directly, rather than through a planning commission (as in India) formulated development plans and policies, and then mobilised the necessary resources. There was an objective need for the state to develop the country; and given the conditions of the country, this could only be done with the state playing the dominant role. Secondly, the state ensured that social welfare and economic growth were achieved simultaneously. For example during the Third FYP (1986-90) when Oman had to implement a self-initiated SAP to adjust its economy to the collapse of the oil price, expenditure on education and health was maintained and was not subject to any cut-backs. Thus, while a number of oil exporting developing countries experienced a decline in human development, Oman was able to improve the average life expectancy, infant mortality and primary enrolment rates. Thirdly, the roles of the market and the private sector were conceptualised as being complementary and the latter was given an important role in the development process. There were no threats to nationalise privately owned enterprises or industry, or reservation of industries for the public sector[1]. As we have shown, profitable SOEs were privatised, when deemed appropriate, as a means of securing the best mixture of the strategies of development. By following this, rather than

[1] As was the case in India till the introduction of economic reforms in July 1991. See Government of India, Ministry of Finance (1992) *Economic Survey*, 1991-92, New Delhi.

alternative paths, Oman was able to turn a discredited development strategy and a hostile environment, as well as negative experiences of other countries to its advantage.

Inspite of the economic and social progress made in Oman, there have been relative failures in a number of areas which are a cause for concern. This is especially so in relation to the diversification of the economy. As we have explained, while Oman has succeeded in reducing its dependence on the oil sector as a major source of its GDP, its attempt to develop the non-oil commodity producing sector has been less than satisfactory.

We have shown that compared to other primary exporting countries like Malaysia, Mexico, and Gabon, Oman had in 1994 the smallest relative share of value-added in manufacturing at 4 per cent; compared to 32, 20, and 11 per cent for the above countries, respectively. Of equal importance is the fact that Oman's GDP has the smallest relative share of value-added by agriculture as well: 3 per cent, as compared to 14, 8, and 8 per cent respectively for Malaysia, Mexico, and Gabon (World Bank, 1996:pp.190 and 211).

Clearly this situation needs to be rectified if Oman is to sustain its present standard of living, once the oil reserves are depleted in about 2020. In fact the government in Oman, through planning and the private sector is currently involved in dealing with this situation, through diversification of the economy within the framework of the Fifth FYP and the 'Vision : 2020' perspective.

8.3 The Four Pillars of Oman's Development Strategy and Policy

The continuing bottlenecks and constraints on Oman's further development and the consolidation and sustaining of the gains secured so far, hinge on the Four Pillars of Oman's Development Strategy and Policy. The aim of this is to accelerate the pace of economic diversification through a state-private sector partnership, a dynamic and efficient private sector, a well-developed human resource and a stable macro-economic framework.

Planning and policy in Oman through these four pillars of New Development Strategy is expected to overcome the constraints on economic growth experienced by Oman during the last decade, covering the Third and Fourth FYP.

8.3.1 Constraints on growth

The major constraints on growth include the continuing low relative share of commodity producing sectors of agriculture and fisheries and manufacturing beyond their combined share of 7 per cent; and on the other, to curb the premature expansion of the services sector. The other three major constraints are: declining rates of savings and capital formation, rapidly growing fiscal deficits and growing unemployment among young Omanis in the face of expanding employment. The salient features of some of these problems are discussed in Oman's New Development Strategy and Policy embodied in Oman's 'Vision 2020' and the Fifth FYP (Oman, 1996a).

8.3.2 Prospects of the New Development Strategy and Policy

The current Fifth FYP is the first of a series of FYPs which will be launched over the next twenty-five years to implement the New Development Strategy and Policy which is articulated within the 'Vision 2020' framework.

The main goal of Oman's 'Vision 2020' is to maintain the present living standard and to work towards doubling the real per capita income by the year 2020. This means, among other things, removal of constraints which we mentioned in the previous section. Specifically, the major objectives of the New Development Strategy and Policy are: diversification of the economy; privatisation and private sector development; and human resource development, all of which are to be implemented within the framework of development planning, and in a context in which the state, in different guises, is of major significance.

To accelerate the pace of diversification, the Fifth FYP (1996-2000), thus places added emphasis on diversifying into high value-added exports, closer integration with the global economy and technology transfer. Based on the projections made for the Omani economy at constant 1993 prices, it is expected that the structure of production and demand in the economy will undergo a profound change.

In the emerging trade structure, the share of oil exports in total exports is expected to decline, while the share of non-oil exports is expected to increase during this period. Reflecting the expected growth in domestic production between 1995 and 2020, the ratio of imports to GDP is envisaged to decline also.

Diversification of the economy and creation of dynamic comparative advantages in an ever changing global political economy requires, *inter alia*, a private sector that is dynamic, efficient and capable of integrating with the world economy. In order to strengthen and expand the role of the private sector in development, the Fifth FYP comprises a number of policies and measures to enhance public-private interaction in the economy. As a result, the private sector is expected to contribute 53 per cent of the total investment planned for the Fifth FYP (compared to its contribution of 35 per cent during the Fourth FYP) (Oman, 1996a). In addition, a number of areas, such as electricity, sewage, gas, water and ports, which have hitherto been in the domain of the public sector will now be opened up for private sector participation.

Rather than viewing globalisation and the state as two mutually exclusive dynamics, the state can facilitate, adapt and interface Oman's economy and society to the new conditions. Similarly, the Fifth FYP includes a framework of policies and regulations which address the dilemmas of privatisation, but also use this as one of the means to achieve economic growth and development.

Human development is the declared ultimate objective of Oman's 'Vision 2020'. To achieve this, human resource development has been identified as one of the main pillars of the New Development Strategy[1]. Hence despite the calls for minimal state intervention by the neo-classicals and the IFIs, the state in Oman continues to support the provision of essential public health services, basic education and increasing the participation of Omanis in the labour market. However, this is combined with the Fifth FYP's objective of eliminating wasteful consumption of health services, upgrading the general education curricula and restructuring the technical education and vocational training systems. To encourage the private sector to invest in the provision of health and education facilities, a number of policies have been initiated. These include, for example provision of soft loans by the state to the private sector for investing in these facilities, expanding the concept of public funding for privately delivered education and vocational training, and expanding procurement of health services and facilities from the private sector.

An important area expected to be influenced by the policies formulated to promote private sector development is the pattern of employment. It is expected that by the year 2000, 48 per cent of the Omani labour force will be employed in the private sector compared to 18 per cent in 1995. Omanisation in the private sector is expected to increase during the Fifth FYP, while overall level of Omanisation of the total labour force will increase from 35.2 per cent in 1995 to 38.9 per cent in 2000.

To support the process of diversification and private sector development, macroeconomic stability will be reinforced. In view of the rising fiscal deficits since the late 1980s, the Fifth FYP includes measures to achieve a balanced budget by the year 2000 and to generate thereafter annual budgetary surpluses to the extent of 3 per cent of GDP. Public debt shall be frozen and the institutions facilitating the development process, such as the State General Reserve Fund shall be further reinforced.

To achieve these objectives, the New Development Strategy and Policy has brought in major shifts in some existing policies, and placed more emphasis on others.

[1] The terms the New Development Strategy and Policy and the New Development Strategy are used interchangeably in this chapter.

Thus a certain degree of import-substituting protectionist measures to create a home market for indigenous industries, and a more flexible approach to exchange rate management to enhance export competitiveness of Omani products will be necessary in this new stage of development. Of course, both a competitive exchange rate to encourage non-oil exports and some import-substituting duties will raise costs of imports and thereby generate some inflationary pressures. But as Evans (1991:p.49) argues "[E]qually, where there are scale economies, depending on the nature of the competition, it may be better to allow a domestic monopoly to reap the benefits of scale economies behind a tariff or export subsidy".

8.3.3 The role of the state and market under the new strategy

An important question arises as to the future role of the state in Oman. Does the New Development Strategy imply a curtailed role for the state and *ipso facto* for development planning?

It has been argued in this thesis that the New Development Strategy involves new and changed functions for the state. State intervention is necessary to mobilise domestic and foreign resources required for accelerating the process of diversification. And to ensure the achievement of the Fifth FYP target of private investment the state continues to undertake facilitating measures such as improving the regulatory framework and upgrading the physical infrastructure. Moreover, the selection of appropriate technology and foreign partners for petrochemical projects and optimising their externalities require government intervention. Because as Rueschemeyer and Evans (1985:p.44) argue, the state must acquire a certain degree of "relative autonomy" from the local dominant elite and foreign investors generally required in these industries.

Nowhere is the role of the state in Oman going to be more pronounced than in the field of human resource development. Upgrading the skills and capabilities of people involve large externalities which the market alone cannot deliver.

In the case of privatisation too, the state's role is crucial to integrate it within the planning process, to enable privatisation to promote efficient resource allocation, and to minimise the human cost of privatisation. The state will regulate private enterprises to ensure they incorporate welfare provisions in their operations.

The market will continue to have an important and enhanced role in implementing the new strategy, since the underlying objective is to build a stronger partnership between the public and private sector, and between the market and the plan. But while the state can accommodate the market mechanism and its discipline within the planning process, the opposite is not true. Because even under ideal conditions, the market, in most developing countries cannot address the concerns which the state aims to address through development planning. For example, in the case of Oman, the operation of free market reflected in liberal trade policy and a flexible expatriate employment policy has thwarted the process of diversification. At the same time it has placed a heavy burden on the petroleum sector to provide the foreign exchange required to pay for the progressively growing volume of imported commodities and services.

8.3.4 The future role of the state in Oman

The New Development Strategy implies a paradigm shift from a phase where the state had assumed a leading role in capital formation, structural transformation, mobilisation of resources and creation of employment to a phase where the role of the state will shift towards strategic guidance, protection of society and facilitation of the development process. The success of the strategy will depend on one hand, on the ability of the state to mobilise public opinion to accept these changes, and on the other, it will depend on the technical ability of the bureaucracy to manage an increasingly complex and integrated (internally and externally) economy.

Equally important is the response of the private sector to this paradigm shift involved in new strategy. The private sector has to shift its emphasis from low value-added to high value-added activities, from services requiring low investment, inexpensive semi-skilled labour and involving low risk, to industrial activities involving long gestation period, high initial investment, skilled labour, and high business risk.

Then there are external factors such as the international political economy and its impact on Oman's economy which can also influence, positively or negatively, the outcome of the new strategy. These include, volatility of the oil market, geopolitics of the Gulf region, which has seen two wars in less than two decades, and the fragile politics of the Middle East. Of course, as discussed in Chapter V, the state in Oman has already created facilitating institutions and mechanisms to mitigate to the extent possible, the negative consequences of these external factors for Oman's development process.

Despite the above challenges, the case for a state-led development strategy is not weakened. Moreover, as Commack (1991:p.39) argues, the market, without the support of the state, cannot succeed either and a turn from interventionist to market-oriented policies requires decisive action. Our analysis indicates that the policies adopted by Oman in the context of the New Strategy can be implemented effectively.

8.4 Future Research

We have demonstrated that state-led development can and has been able to promote successful development, including in Oman. However, further research is needed to understand the impact of social, political and cultural processes which make such a strategy succeed in some countries and fail in others. In other words, what is the mix of socio-cultural and political factors that have led to uneven results of planning in mixed developing economies?

In the case of Oman, more work needs to be done, for example, on the potential role of agriculture in Oman's economy and society. The scope and content of an active industrial policy also needs to be examined in conjunction with a study of the policies concerning import trade, exchange rate mechanism, foreign investment and labour market and their significance for the pace of the diversification process. The question of Oman's competitiveness in the international economy and the policies required to face the challenges of globalisation also need to be studied in depth.

8.5 Concluding Remarks : the Importance of State in Developing Economies

As we come to the end of the millennium, and to the end of our thesis, the debate surrounding the state and markets is far from settled. Indeed it is too early to write on the demise of the state and development planning.

In the face of emerging trends in international political economy, gloablisation appears to be inescapable and, in some ways, even beneficial as it may prevent a country from technological stagnation. But on this basis one cannot dismiss the demands of national sovereignty as misguided because the experience of developing countries justifies these demands. As we have discussed in this thesis, the neo-classical formula of structural adjustment programmes has resulted in social and economic dislocation, economic insecurity, persistent unemployment and a dangerous erosion of trust in political and economic institutions. And despite the hardship, the promised benefits are yet to materialise.

On the other hand, it is by now widely accepted that the success stories of East Asian economies repeatedly told by the neo-classical and the World Bank economists are models not of market liberalism but of aggressive and judiciously selective state intervention[1].

The main lesson that the East Asian experience teaches is that even if globalisation and economic liberalisation are inevitable, these processes have to be managed by a national economy in accordance with a set of socially rooted and politically legitimated values and priorities. Failure to do so would lead to instability, conflict and polarisation[2]. This supports Bienefeld's (1996) argument that economic liberalisation under the present imbalances in the global political economy, is not necessarily beneficial, and protection or intervention is not necessarily detrimental.

As we have shown in relation to Oman, the choice therefore between markets and government is a matter of degree of involvement and that the choice need not be permanent or invariant; the choice has to change according to the particular stage of development. We have argued that as a general allocative mechanism markets do accomplish a number of tasks, many of them critical for static and dynamic efficiency,[3] the existence of competitive markets cannot be taken for granted in many developing countries. Therefore, in addition to the provision of pure public goods like defence and public order, the state can contribute to improvements in the functioning of markets by

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[1] The irony of the recent unfolding of the currency and stock market crises in the Southeast Asian economies (Singapore, South Korea, Taiwan, Hong Kong, Indonesia, Malaysia, Philippines and Thailand) lies in the fact that while these economies were seen as shining examples of the triumph of markets over states (as discussed in Chapters I, II and III), and while their success was attributed to good macroeconomic management, secure bank-based financial systems and an efficient allocation of resources (World Bank, 1993b), these are the very factors which are now blamed for these crises. In South Korea, for example, the recent stock market tumble is attributed to corporate indebtedness and slowness of reform, though in 1993, one World Bank (1993b) study found South Korea's policy of banking supervision and credit allocation to be exemplary. Similarly, while East Asian economies were praised for using markets to promote high rate of capital accumulation and inducing large inflow of foreign investments, it is now argued that most of the money went into property development, speculation and building factories for which there is little demand.

[2] What rapid globalisation and liberalisation can do in hitherto regulated economies is clearly manifested by the recent currency and stock market crisis in the latecomers on the East Asian scene, namely, Indonesia, Malaysia and Thailand.

[3] Static efficiency relates to realising a higher ratio between outputs, on the one hand, and inputs, on the other, while dynamic efficiency relates to sustaining a higher rate of economic growth over time (Wolf, Jr. 1994:p.157).

establishing those institutions that are necessary for their efficient functioning and maintaining a stable macroeconomic framework.

In fact the World Bank (World Bank, 1997a), generally an ardent supporter of globalisation and liberalisation, in its latest *World Development Report* realises now that good economic policies require capable state institutions. It also recognises the concerns that have been growing about the potentially destabilising effects of large and rapid flows of portfolio capital, particularly when a crisis in one country can spill over into other markets, as has been the case recently in the East Asian markets. In fact, in contrast to its previous call for "rolling back" the state, one can discern signs in the report of "bringing back" the state. "[T]his makes the *state's role all the more critical* both in handling such shocks and in *helping people and firms grasp the opportunities* of the global market-place" (World Bank, 1997a:pp.1-12; emphasis added by the present author). That is why the end of history and the demise of the state will remain a futile dream.

But if the state and *ipso facto* development planning is worth restoring, what are the requirements for ensuring its success? As we have discussed in this thesis with reference to Oman's experience and a number of other developing countries, states like markets are not natural given phenomenon but institutions comprising of various interest groups. Hence as we have shown with regard to Oman in addition to creating a competent bureaucracy dedicated to the state and to collective goals, there is need for strong political commitment and support from the leadership for socio-economic development. A degree of "state autonomy" is another essential requirement for successful development. Without a certain degree of autonomy, the best laid plans and policies can be frustrated by divergent vested interests. And while these elements are of prime importance in achieving a successful transformation, the state must not over-ride the market. The role of the state in the development process should be articulated effectively within a market-oriented economy rather than one of central control and direction.

To conclude, development is a dynamic process and, therefore, needs a dynamic approach. Policies and strategies have to respond to the ever changing domestic and international environment. The state can neither monopolise the process, nor can the markets function on their own. Both states and markets must work in a spirit of co-operation to achieve the supreme objective of development — that is, Human Development.

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